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ABSTRACT

This document is a congressional joint hearing report of a panel discussion exploring issues related to privatization of two government-sponsored entities (GSEs): the Student Loan Marketing Association (Sallie Mae) and the College Construction Loan Insurance Association (Connie Lee). The two issues specifically addressed by the panel were: (1) whether these GSEs were mature enough to make privatization desirable, and (2) what effects privatization might have on their investors. The report includes prepared statements by panel members Darby Bradbury, Department of Treasury, who testified in favor of privatization and also presented some historical background on the Treasury's longstanding relationship with Sallie Mae, and its position on Connie Lee; Lawrence Hough, Student Loan Marketing Association, who also supported privatization; Leo Kornfeld, Department of Education, who raised some special issues relative to privatization of Sallie Mae; and Oliver Sockwell, College Construction Loan Insurance Association, who sought complete privatization of his organization. Included also are statements by panel members Fred Khedouri, of Bear, Stearns & Company, and Robert Torrey; the transcript of the question-and-and-answer session that followed the formal presentation; and statements submitted by other interested parties. (CH)

HE

JOINT HEARING ON PRIVATIZING GOVERNMENT SPONSORED ENTITIES (GSEs)

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON
POSTSECONDARY EDUCATION, TRAINING AND
LIFE-LONG LEARNING

OF THE

COMMITTEE ON ECONOMIC AND
EDUCATIONAL OPPORTUNITIES

AND THE

SUBCOMMITTEE ON NATIONAL ECONOMIC GROWTH,
NATURAL RESOURCES, AND REGULATORY AFFAIRS

OF THE

COMMITTEE ON GOVERNMENT REFORM
AND OVERSIGHT

HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, DC, MAY 3, 1995

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JOINT HEARING ON PRIVATIZING GOVERNMENT SPONSORED ENTITIES (GSEs)

WEDNESDAY, MAY 3, 1995

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON POSTSECONDARY EDUCATION, TRAINING AND LIFE-LONG LEARNING, COMMITTEE ON ECONOMIC AND EDUCATIONAL OPPORTUNITIES, JOINT WITH SUBCOMMITTEE ON NATIONAL ECONOMIC GROWTH, NATURAL RESOURCES AND REGULATORY AFFAIRS, COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT, *Washington, DC.*

The subcommittee met, pursuant to call, at 9:30 a.m., Room 2175, Rayburn House Office Building, Hon. Buck McKeon, Chairman, and Hon. David McIntosh, Chairman, presiding.

Members present: Representatives McKeon, Gunderson, McIntosh, Petri, Williams, Reed, Roemer, Green, Peterson, McIntosh, Slaughter, Kanjorski, and Condit.

Also present: Representatives Edwards and Meyers.

Staff present: George Conant, Professional Staff Member; Rick Jerue, Counsel; June Harris, Education Coordinator; Jo-Marie St. Martin, Parliamentarian; Sally Stroup, Professional Staff Member; Mary Ann Fitzgerald, Legislative Assistant; Karen Barnes, Professional Staff Member; David White, Clerk; Mildred Webber, Staff Director; Todd Gaziano, Senior Counsel; Bruce Gwinn, Senior Policy Analyst; and David McMillen, Professional Staff Member.

Chairman MCKEON. Good morning. I'd like to take a moment to welcome our witnesses and those who are here this morning for this hearing, the privatization of government-sponsored enterprises has never been tried before. We are certainly looking forward to your expert testimony as we consider this task.

I'd also like to thank Subcommittee Chairman McIntosh, the Members of his Subcommittee on National Economic Growth, Natural Resources and Regulatory Affairs, for agreeing to join us here today. Clearly, the privatization of GSEs is a matter of interest to his subcommittee, and we look forward to working with him as we continue this process.

Today, we'll be exploring the privatization of the two GSEs under the jurisdiction of the Subcommittee on Postsecondary Education, Training, and Life-Long Learning and the Student Loan Marketing Association, or Sallie Mae, and the College Construction Loan Insurance Association, or Connie Lee.

Sallie Mae was established under a Federal charter in 1972 to ensure adequate private sector funding for federally guaranteed student loans. Sallie Mae has served this purpose primarily by pro-

viding a secondary market for these loans, providing needing capital to be reloaned to students.

Connie Lee was established in 1986, also under a Federal charter. Connie Lee helps colleges and universities obtain low-cost, long-term capital for facilities construction by insuring or reinsuring bonds issued by these institutions.

It's important to note that both of these corporations are stockholder owned. They operate as private entities, but are limited in the scope of their operations by the Federal charter which created them.

As I stated earlier, today we will be exploring uncharted ground. We will be looking into the privatization of government-sponsored entities, whether the markets that these entities serve have matured enough to make privatization desirable, and the effects that privatization would have on those who have invested in these entities in good faith, in order to improve postsecondary education in this country.

I look forward to exploring this area in depth and to hearing the testimony of the witnesses.

We have a little light here that we ask that you conclude your opening statements within the five minutes. When the yellow light comes on, you have a minute left, and that gives us more time for question and answers. We have your full written statements, if you want to summarize those or whatever you would like to say, we would appreciate it and really appreciate you being here today.

We have on our first panel Ms. Darcy Bradbury, Deputy Assistant Secretary for Federal Finance, Department of the Treasury, Washington, DC, Mr. Leo Kornfeld, Senior Advisor to the Secretary, Department of Education, Mr. Lawrence Hough, President and Chief Executive Officer, the Student Loan Marketing Association, and Mr. Oliver Sockwell, President and Chief Executive Officer, the College Construction Loan Insurance Association. We'll hear first from Ms. Bradbury, please.

STATEMENT OF DARCY BRADBURY, DEPUTY ASSISTANT SECRETARY FOR FEDERAL FINANCE, DEPARTMENT OF TREASURY

Ms. BRADBURY. Thank you.

Chairman McKeon, and Members, on behalf of Secretary Rubin, I welcome the opportunity to appear before you today to discuss the administration's proposals to cut the ties to the Federal Government of two government-sponsored enterprises, Sallie Mae and Connie Lee. The Treasury has for a number of years, in Democratic and Republican Administrations, believed that is appropriate to wean a GSE from Federal sponsorship once the GSE becomes economically viable and successfully fulfills the purpose for which it was created with Federal sponsorship, or when the purpose for which it was created ceases to exist.

The GSEs expose the government to the market's perception of implicit risk that legislation would be enacted to prevent a GSE from defaulting on its obligations. As the Treasury said in its 1990 report on GSEs:

The market perception of Federal backing for GSEs weakens the normal relationship between the availability and cost of funds to the GSEs and the risks that these enterprises assume.

In April, 1991, as required by FIRREA and the Omnibus Budget Reconciliation Act of 1990, the Treasury followed up with a further report on the GSEs. As part of that 1991 report, Standard and Poors assessed the likelihood that a GSE would be able to meet its future obligations from its own resources and expressed that likelihood as a traditional credit rating. S&P gave a triple-A credit rating to Sallie Mae. Connie Lee had obtained a triple-A credit rating from S&P previously, and in March, 1990, S&P indicated to the Treasury that Connie Lee's status as a GSE was not a factor in granting the triple-A rating to Connie Lee as a bond reinsurer.

In 1992, legislation was enacted to provide for Federal financial safety and soundness oversight of both the housing-related GSEs, Fannie Mae and Freddie Mac, as well as Sallie Mae, to mitigate the perception of implicit risk to the Federal Government.

As a general principle, we believe that the government and the GSEs would benefit from removal of government ties because privatizing the GSEs would:

1. Reduce the amount of GSE debt, over time, that carries some perception of U.S. government support;
2. Demonstrate our commitment to moving from creating effective public-private partnerships and then privatizing when government support for an activity is no longer needed;
3. Show the financial markets that the government respects the interests of private bond and shareholders; and
4. Support efforts to create new GSEs in the future when appropriate, by demonstrating that the Federal relationship can be severed when the time is right.

Sallie Mae first. Under legislation enacted in 1992, the Treasury has a special relationship with Sallie Mae as its financial safety and soundness regulator. We have reviewed Sallie Mae's financial condition and can see their successes to date and challenges for the future. Sallie Mae's balance sheet grew rapidly in the 1980s, when it expanded market share in response to opportunities arising from amendments to its charter. The company's earnings record was especially strong in 1992, 1993, and early 1994, when market interest rates were low and Sallie Mae was able to capture windfall profits as a result of a floor on the interest rate on most of its student loan assets. Since then, return on assets and net interest margin have been negatively impacted by a rise in market rates of interest and shifts towards lower yielding assets.

The financial environment for Sallie Mae has changed since enactment of the Student Loan Reform Act of 1993, which reduced the returns on guaranteed student loans and imposed a 30 basis point fee on all guaranteed student loans purchased by Sallie Mae after that time. Even more significantly, the Act established the Federal Direct Student Loan Program, under which loan capital is provided directly to students and parent borrowers by the Federal Government rather than through private lenders.

The Student Loan Reform Act authorizes the Department of Education to replace up to 60 percent of the new loan volume with di-

rect lending by the 1998 academic year, and provides that that proportion may grow if there is demand.

The Direct Student Loan Program is one of the President's top priorities. The administration, in the budget for fiscal year 1996, proposed implementation of 100 percent direct lending in 1997. Consistent with the implementation of direct lending under current law, the administration has been studying the options for the future of Sallie Mae, including, in particular, restructuring the company into a fully private company.

In any restructuring, currently outstanding Sallie Mae debt would retain the characteristics of GSE debt, and customers with preexisting commitments with the GSE would not be affected. However, any new debt issued by a private company successor to Sallie Mae would not possess the characteristics of GSE debt.

The administration believes the benefits to be gained by the government and Sallie Mae from privatization, in the context of continued expansion of the Direct Student Loan Program, are such that Congress should favorably consider legislation to authorize Sallie Mae's management to form a fully private company and to wind down the GSE during a transition period.

In this connection, we have been working with the Department of Education and others in the administration to develop a legislative proposal, and we look forward to sharing that with you in the near future. Key elements of the proposal are:

—The Sallie Mae Board of Directors would be authorized to carry out a reorganization, after which Sallie Mae would be a wholly-owned subsidiary of an ordinary State-chartered holding company;

—The reorganization plan would be subject to certain reviews by the Departments of Education and Treasury, followed by approval by holders of a majority of Sallie Mae common stock;

—After the reorganization, Sallie Mae would enter a transition period during which new business activities of the GSE would be restricted and new debt issued by the GSE would be restricted;

—During the transition, excess capital of the GSE could be transferred to the new private holding company subject to certain limitations, in particular, continued compliance with the GSE's statutory capital requirements;

—During the transition, the GSE would be protected from the financial failure of the private holding company or its other private subsidiaries;

—As a form of "exit fee," to recognize the benefits Sallie Mae has received because of its GSE status, the legislation would enable the United States to participate in the success of the holding company, for example, through the issuance of stock warrants, and, in addition, the rest of the legislation must be revenue neutral.

Turning to Connie Lee, the administration proposed in the budget for fiscal year 1996 to convert Connie Lee to a fully private enterprise. Connie Lee was originally structured by Congress as a private, for-profit corporation, but provided for a limited infusion of Federal capital in the form of stock purchases by the Secretary of

Education in order to the get corporation started. Congress clearly intended the Federal Government's direct interest in Connie Lee to diminish and eventually terminate, as evidenced by the statutory limitations on purchases of stock by the Secretary of Education and the authorization of the sale of such stock.

The administration will soon propose legislation that will sever all Federal ties with Connie Lee, largely by requiring that Connie Lee stock that is held by the Department of Education be sold by a date to be specified in the bill. The legislation would also delete Federal approval of directors and eliminate all business restrictions. In marketing securities, Connie Lee would have to notify potential investors of these changes. The Treasury is prepared to act on behalf of the Department of Education to sell the government's stake in Connie Lee. Thus, Connie Lee would be permitted to pursue business opportunities and the Federal Government would be free of any perception of implied risk.

We appreciate the opportunity to testify on these two proposals. Privatization, if implemented in a careful and deliberate manner, can benefit the U.S. government and taxpayers, as well as Sallie Mae's and Connie Lee's shareholders, and also the students and the schools that we are all trying to serve.

Thank you.

Chairman MCKEON. Thank you very much.

[The prepared statement of Ms. Bradbury follows:]

STATEMENT OF DARCY BRADBURY
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
FOR FEDERAL FINANCE BEFORE THE
SUBCOMMITTEE ON POSTSECONDARY EDUCATION, TRAINING
AND LIFELONG LEARNING OF THE COMMITTEE ON ECONOMIC AND
EDUCATIONAL OPPORTUNITIES AND THE
SUBCOMMITTEE ON NATIONAL ECONOMIC GROWTH,
NATURAL RESOURCES AND REGULATORY AFFAIRS OF THE
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
UNITED STATES HOUSE OF REPRESENTATIVES
MAY 3, 1995

Chairman McKeon, Chairman McIntosh, members, on behalf of Secretary Rubin, I welcome the opportunity to appear before you today to discuss the Administration's proposals to cut the ties to the Federal Government of two Government-sponsored enterprises ("GSE's") -- the Student Loan Marketing Association (Sallie Mae) and the College Construction Loan Insurance Association (Connie Lee). The Treasury has for a number of years, in Democratic and Republican Administrations, believed that it is appropriate to wean a GSE from Federal sponsorship once the GSE becomes economically viable and successfully fulfills the purpose for which it was created with Federal sponsorship, or when the purpose for which it was created ceases to exist.

The GSEs expose the Government to the market perception of implicit risk that legislation would be enacted to prevent a GSE

from defaulting on its obligations. As the Treasury said in its 1990 Report on GSEs[1]:

> The market perception of Federal backing for GSEs weakens the normal relationship between the availability and cost of funds to the GSEs and the risks that these enterprises assume . . . The prospect that Congress would use taxpayer funds to prevent the failure of a GSE is perceived in the securities markets as protecting investors in GSE debt securities or GSE-guaranteed securities from loss . . .

In April 1991, as required by FIRREA and the Omnibus Budget Reconciliation Act of 1990[2], the Treasury followed up with a further report on the GSEs in 1991.[3] The 1991 Report reiterated statements of concern about the Government's risk exposure to the GSEs. At the Treasury's request, as part of the 1991 Report, Standard and Poors (S&P) assessed the likelihood that a GSE would be able to meet its future obligations from its own resources and expressed that likelihood as a traditional credit rating. S&P gave a triple-A credit rating to Sallie Mae. Connie Lee had obtained a triple-A credit rating from S&P previously, and in March 1990, S&P indicated to the Treasury that Connie Lee's status as a GSE was not a factor in granting the triple-A rating to Connie Lee as a bond reinsurer.

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[1] Report of the Secretary of the Treasury on Government-sponsored Enterprises, May 1990, page 1. This 1990 Report was required under section 1404 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)(P.L. 101-73).

[2] Public Law 101-508, section 13501.

[3] Report of the Secretary of the Treasury on Government-sponsored Enterprises, April 1991, or the 1991 Report.

In 1992, legislation was enacted to provide for Federal financial safety and soundness oversight of the housing-related GSEs -- the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation -- and Sallie Mae to mitigate the perception of implicit risks to the Government. Federal oversight of the Farm Credit System had been tightened earlier as a result of problems that arose and required Federal assistance in the mid-1980s.

As a general principle, we believe that the Government and the GSEs would benefit from removal of the Government ties because privatizing the GSEs would:

-- Reduce the amount of GSE debt, over time, that carries some perception of U.S. Government support;

-- Demonstrate our commitment to moving from creating effective public-private partnerships to then enabling complete privatizing when Government support for an activity is no longer needed;

-- Show the financial markets that the Government respects the interests of private bond- and shareholders; and

-- Support Federal efforts to create new GSEs in the future, when appropriate, by demonstrating that the Federal relationship can be severed when the time is right. A business operation that starts as a GSE with a limited charter can be freed to operate in other markets once it has fulfilled the purpose for which it was created.

Sallie Mae

Under legislation enacted in 1992,[4] the Treasury has a special relationship with Sallie Mae as its financial safety and soundness regulator. We have reviewed Sallie Mae's financial condition and can see their successes to date and challenges for the future. Sallie Mae benefitted from large increases in leverage and relatively low cost GSE funding through the early 1990s. Sallie Mae's balance sheet grew rapidly in the 1980s, when it expanded market share in response to opportunities arising from amendments to its charter. The company's earnings record was especially strong in 1992, 1993, and early 1994, when market interest rates were low and Sallie Mae was able to capture windfall profits as a result of a floor on the interest rate on most of its student loan assets. Since then, however, return on assets and net interest margin have been negatively impacted by a rise in market rates of interest and shifts towards lower yielding assets.

The financial environment for Sallie Mae has changed since enactment of the Student Loan Reform Act of 1993[5], which reduced the returns on guaranteed student loans and imposed a 30 basis

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[4] P.L. 102-325, enacted on July 23, 1992, added subsection 439(r) to the Sallie Mae charter in the Higher Education Act of 1965 (20 U.S.C. 1087-2(r)), providing a capital standard for Sallie Mae and for Treasury financial safety and soundness oversight.

[5] P.L. 103-66, Subtitle A of the Omnibus Budget Reconciliation Act of 1993.

point fee on all guaranteed student loans purchased by Sallie Mae after August 10, 1993. Even more significantly, the Act also established the Federal Direct Student Loan Program (now the William D. Ford Direct Loan Program), under which loan capital is provided directly to student and parent borrowers by the Federal Government rather than through private lenders.

The Student Loan Reform Act authorizes the Department of Education to replace up to 60 percent of (new loan volume in) the Federal guaranteed student loan programs with direct lending by the Department of Education by the 1998 academic year, and further provides that the proportion of direct loans may rise above 60 percent, if the Secretary of Education "determines that a higher percentage is warranted by the number of institutions of higher education that desire to and are eligible to participate in the program . . ."[*]

The Direct Student Loan Program is one of the President's top priorities. The Administration, in the Budget for FY 1996, proposed implementation of 100-percent direct lending (new loan volume) in 1997. Consistent with the implementation of direct lending under current law, the Administration has been studying options for the future of Sallie Mae, including in particular, restructuring the company into a fully private company. As noted above, privatizing Sallie Mae would significantly benefit the

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[*] Subsection 453(a) of the HEA of 1965, as amended (20 U.S.C. 1087c(a)).

U.S. Government. In addition, removing Federal ties would mean that the restrictions on Sallie Mae's business operations under its current charter would cease to exist and that Sallie Mae could engage in profit-making activities that it cannot enter as a GSE.

In any restructuring, currently outstanding Sallie Mae debt would retain the characteristics of GSE debt, and customers with pre-existing commitments with the GSE would not be affected. Any new debt issued by a private company successor to Sallie Mae would not possess the characteristics of GSE debt.

The Administration believes that the benefits to be gained by the Government and Sallie Mae from privatization, in the context of continued expansion of the Direct Student Loan Program, are such that Congress should favorably consider legislation to authorize Sallie Mae's management to form a fully private company and to wind down the GSE during a transition period.

In this connection, we have been working with the Department of Education, the Office of Management and Budget, the Domestic Policy Council, and the National Economic Council to develop legislation to privatize Sallie Mae. We look forward to sharing an Administration legislative proposal with Congress in the near future. Key elements of the proposal are:

-- The Sallie Mae Board of Directors would be authorized to carry out a reorganization, after which Sallie Mae would be a wholly-owned subsidiary of an ordinary state-chartered holding company;

-- The reorganization plan would be subject to certain reviews by the Departments of Education and Treasury followed by approval by holders of a majority of Sallie Mae common stock;

-- After the reorganization, Sallie Mae would enter a transition period during which new business activities of the GSE would be restricted and new debt issued by the GSE would be restricted;

-- During the transition, excess capital of the GSE could be transferred to the new private holding company subject to specific limitations and approval of the Secretaries of Education and Treasury, and continued compliance with the GSE's statutory capital requirements;

-- During the transition, the GSE would be protected from the financial failure of the holding company or its other subsidiaries;

-- As a form of "exit fee", to recognize the benefits Sallie Mae has received because of its GSE status, the legislation would enable the United States to participate in the success of the holding company, for example through the issuance of stock warrants, and in addition, the rest of the legislation must be revenue neutral.

Connie Lee

The Administration proposed in the Budget for FY 1996 to convert Connie Lee to a fully private enterprise. Congress structured Connie Lee as a private, for-profit corporation, but provided for a limited infusion of Federal capital in the form of stock purchases by the Secretary of Education in order to get the corporation started. Congress clearly intended the Federal Government's direct interest in Connie Lee to diminish and eventually terminate,[1] as evidenced by the statutory limitations on purchases of stock by the Secretary of Education and the authorization of the sale of such stock.

The Administration will soon propose legislation that will sever all Federal ties with Connie Lee, largely by requiring that the Connie Lee stock that is held by the Department of Education be sold by a date to be specified in the bill[2]. The legislation would also delete Federal approval of directors and eliminate all business restrictions. In marketing securities, Connie Lee would have to notify potential investors of these changes. The Treasury is prepared to act on behalf of the Department of Education to sell the Government's stake in Connie Lee. Thus,

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[1] U.S. Congress, House, Committee on Education and Labor, Higher Education Amendments of 1985, 99th Congress, 1st sess., 1985, H. Rept. 99-383 to accompany H.R. 3700, page 74.

[2] In the 1990 Report, the Treasury proposed that the Federal Government sell its Connie Lee stock when it had authority to do so (February 1992).

Connie Lee would be permitted to pursue business opportunities and the Federal Government would be free of any perception of implied risk that it would be called upon to provide assistance in the unlikely event that Connie Lee gets into financial difficulty.

Conclusion

We appreciate the opportunity to testify on these two proposals. Privatization, if implemented in a careful and deliberate manner, can benefit the U.S. Government and taxpayers, as well as Sallie Mae's and Connie Lee's stockholders, and the students and schools we are all trying to serve.

I will be glad to answer any questions that you may have.

Chairman MCKEON. Mr. Kornfeld.

STATEMENT OF LEO KORNFELD, SENIOR ADVISOR TO THE SECRETARY, DEPARTMENT OF EDUCATION

Mr. KORNFELD. Chairman McKeon, thank you very much for the opportunity of presenting the Department of Education's position on privatization of these two agencies.

First, as Ms. Bradbury pointed out, in principle, the administration supports the privatization of government-sponsored enterprises when the special privileges that have been bestowed upon them as part of that status are no longer necessary to perform the functions for which they were created.

GSE, in our opinion, GSE privileges should be viewed as temporarily conferred by the government for limited purposes and not as a permanent property right of the GSE owners and management.

First, I'd like to discuss Connie Lee, which is the less federally connected of the two enterprises we are talking about this morning, where the administration has progressed further to on the legislation, and then turn to Sallie Mae.

Before doing so, however, I would like to put these actions in the larger context of the administration's commitment to reinventing government. The privatization of Connie Lee and Sallie Mae are consistent with the President's effort to improve the way government does business, to cut bureaucracy and regulations. Moving forward on this agenda is the right thing to do, not because privatization is a popular subject or popular idea, but because it is the smart thing to do.

First, let me talk about Connie Lee. Connie Lee, as you pointed out, Mr. Chairman, was established by the Higher Education Amendments of 1986, to assist in the financing of postsecondary education facilities. Since then, Connie Lee has provided insurance and reinsurance for almost $10 billion of construction financing, supporting more than 1,000 higher education facility projects.

The administration expects to propose legislation very soon to privatize Connie Lee in a manner that protects the interests of the taxpayer. Privatizing Connie Lee would signal an important shift in the way the government does business. It would eliminate a Federal presence where the operation of market forces would be more than equitable and suitable, and it would contribute toward reducing the scope of government. It would remove restrictions on Connie Lee's operations, and it would return funds to the United States Treasury through the sale of the Secretary of Education's holdings of Connie Lee voting common stock, which is about 14 percent of the common stock of Connie Lee today. The administration's proposal will allow Connie Lee to apply the insurance and reinsurance expertise that they have developed without government-imposed constraints.

Enacting the administration's legislation would allow market forces to operate free of statutory impediments and bureaucratic oversight. The Department looks forward to working with you to pass this legislation.

Now, to Sallie Mae. Sallie Mae, as you pointed out, Mr. Chairman, was created by the Education Amendments of 1972, to provide a secondary market for guaranteed student loans. The author-

ization and successful launching of the Direct Loan Program has raised the question of the extent to which the functions currently assigned to Sallie Mae under the FFEL program will be necessary in the future. Obviously, the administration's proposal for a complete transition from guaranteed loans to direct lending would result in the elimination of the new guaranteed loan volume for Sallie Mae to purchase or to fund through warehousing advances. Thus, privatization, with the accompanying ability to engage in other business activities, is a logical result of 100 percent direct lending. Even under current law, however, the volume of new guaranteed loans and, thus, the need for Sallie Mae to support that program, will be substantially diminished. Some 40 percent of all new loan volume will be handled by direct rather than guaranteed student loans in the next academic year, increasing under current law to 60 percent by the 1998 academic year.

An interagency working group has been working on that, which includes Treasury, as well as the National Economic Council and the Office of Management and Budget, and this group has been meeting regularly to develop the administration's approach to the privatization of Sallie Mae.

The privatization of any GSE is a very difficult and complex undertaking. The sheer size of Sallie Mae, which, by the way, is over $50 billion in assets and nearly 5,000 employees, make its potential privatization a particularly challenging undertaking. The interagency group has made very good progress, and at this stage drafts of privatization legislation are under active discussion.

There are also, however, a number of special issues that need to be discussed as part of the privatization of Sallie Mae, and those are three, namely, the continuing need of Sallie Mae, the offset fee and the exit fee. First, the continuing need.

With a variety of proposals currently pending to change the current schedule for the transition to direct lending, there is substantial uncertainty about the future new volume of guaranteed loans. As you know, there are legislations that Congress is now considering to go from zero percent direct loans in the future to 100 percent direct loans, and, obviously, this has a major impact on what the role of a secondary market such as Sallie Mae will have. Moreover, in fiscal year 1995, 1994 rather, we saw a 29 percent increase in the student loan volume, and that plans to be continued.

The offset fee will cost $250 million in the next five years, which is part of the law, and the exit fee, we feel there should be reasonable compensation to the Federal Government for the financial benefits that Sallie Mae has enjoyed as a result of its statute as a GSE.

I'd be very happy to answer any questions. I see the red light, unfortunately.

Chairman MCKEON. Thank you, very much.

[The prepared statement of Mr. Kornfeld follows:]

TESTIMONY OF LEO KORNFELD, SENIOR ADVISOR TO THE SECRETARY
UNITED STATES DEPARTMENT OF EDUCATION

Mr. Chairman and Members of the Subcommittees:

I am pleased to appear at this joint hearing to present the views of the Department of Education with respect to privatization of the College Construction Loan Insurance Association (Connie Lee) and the Student Loan Marketing Association (Sallie Mae).

In principle, the Administration supports the privatization of government-sponsored enterprises (GSEs) when the special privileges that have been bestowed upon them as part of that status are no longer necessary to perform the functions for which they were created, or the assigned functions themselves are no longer necessary. Depending upon the particular privileges bestowed upon a specific GSE, GSE status increases the demand for credit in the Government sector, reduces tax revenues, creates the possibility of further government assistance to achieve the public purposes for which the GSE was created, and gives the GSE competitive advantages over private entities performing the same functions. GSE privileges should be viewed as temporarily conferred by the Government for limited purposes and not as a permanent property right of the GSE owners and management.

First, I will discuss Connie Lee, the less federally-connected of the two enterprises, where the Administration has progressed further on legislation, and then turn to Sallie Mae. Before

doing so, however, I would like to put these actions in the larger context of the Administration's commitment to Reinventing Government. The privatization of Connie Lee and Sallie Mae are consistent with the President's efforts to improve the way Government does business, to cut bureaucracy and regulation. Moving forward on this agenda is the right thing to do not because privatization is a popular idea, but because it is the smart thing to do.

Connie Lee

Connie Lee was established by the Higher Education Amendments of 1986 to assist in the financing of postsecondary education facilities. Since then, Connie Lee has provided insurance and reinsurance for almost $10 billion of construction financing, supporting more than 1,000 higher education facilities projects.

The Administration expects to propose legislation very soon to privatize Connie Lee in a manner that protects the interest of the taxpayer. The Administration believes that full privatization of Connie Lee would be in the best interests of the Government, Connie Lee, and educational institutions--a position with which Connie Lee concurs.

Privatizing Connie Lee would signal an important shift in the way the Government does business. It would eliminate a Federal

presence where the operation of market forces would be more suitable, and it would contribute toward reducing the scope of Government. It would remove restrictions on Connie Lee's operations, and it would return funds to the United States Treasury through the sale of the Secretary of Education's holdings of Connie Lee voting common stock. The Administration's proposal will allow Connie Lee to apply its insurance and reinsurance expertise without Government-imposed constraints.

There is a perception in the financial community that the finances and operations of Connie Lee are backed implicitly by the Federal Government. The Administration seeks to dispel any such notion. By removing statutory restrictions on Connie Lee from the Higher Education Act of 1965 (HEA), selling the Department's minority ownership of Connie Lee, and removing the four Government-appointed directors, all links to the Government would be eliminated.

Connie Lee is generally restricted by the HEA to serving only postsecondary institutions with relatively low financial ratings. Since current statutory provisions make it difficult for Connie Lee to provide services to the best-rated institutions, the corporation has determined that it cannot offer services to the lowest-rated institutions and still maintain a balanced portfolio and its own good rating. As a result, Connie Lee's insurance and reinsurance business among the lowest-rated schools has been

limited. By repealing the current authorization, Connie Lee believes it would be able to serve those schools better.

Furthermore, restricting Connie Lee's business to the postsecondary education sector (including teaching hospitals) prevents the association from serving elementary and secondary education institutions, as well as many other public service entities that may require construction financing insurance or reinsurance. An expansion of Connie Lee's business beyond postsecondary education, but without any actual or perceived government tie, could contribute to the public benefit.

Enacting the Administration's legislation would allow market forces to operate free of statutory impediments and bureaucratic oversight. The Department looks forward to working with you to pass this legislation.

Sallie Mae

Sallie Mae was created by the Education Amendments of 1972 to provide a secondary market for guaranteed student loans.

The authorization and successful launching of the William D. Ford Federal Direct Loan Program has raised the question of the extent to which the functions currently assigned to Sallie Mae under the FFEL program will be necessary in the future. Obviously, the

Administration's proposal for a complete transition from guaranteed to direct lending would result in the elimination of new guaranteed loan volume for Sallie Mae to purchase or to fund through warehousing advances. Thus, privatization, with the accompanying ability to engage in other business activities, is the logical result of 100 percent direct lending. Even under current law, however, the volume of new guaranteed loans, and thus the need for Sallie Mae to support that program, will be substantially diminished. Some 40 percent of all new loan volume will be handled by direct rather than guaranteed lending in the next academic year, increasing under current law to 60 percent by the 1997-98 academic year.

In recognition of these developments, last autumn the Secretary of Education and the Secretary of the Treasury wrote the then-Chairmen of the House Education and Labor Committee and the Senate Labor and Human Resources Committee that "the most promising approach now under consideration is to use the transition period (from guaranteed to direct loans) to restructure Sallie Mae from a GSE that has certain ties to the Federal Government into a completely private enterprise." Since then, an interagency working group composed of representatives of the two Departments, the Domestic Policy Council, the National Economic Council, and the Office of Management and Budget has been meeting on a regular basis to develop the Administration's approach to the privatization of Sallie Mae. Sallie Mae has

worked closely with the working group about its likely business prospects as a totally private entity.

The privatization of any GSE is a very difficult and complex undertaking. The sheer size of Sallie Mae (over $50 billion in assets and nearly 5,000 employees) makes its potential privatization a particularly challenging undertaking. The interagency group has made very good progress.

In considering the potential privatization of Sallie Mae, the interagency group has attempted to balance the often competing interests of students, the stockholders of Sallie Mae, and the taxpayer. There are also a number of special issues that the interagency group is addressing:

1. Continuing need. With a variety of proposals currently pending to change the current schedule for the transition to direct lending, there is substantial uncertainty about the future new volume of guaranteed loans. Moreover, FY94 saw a 29 percent increase in total new volume of student loans, as contrasted with the average 7.85 percent annual increase over years since 1986. Even if all new guaranteed loan volume were to cease today, there would still be a portfolio of $113 billion, measured in original principal amount of outstanding guaranteed loans. Therefore, any legislation must take into account the protection of these student borrowers and ensure that privatization happens in an

orderly manner. The Federal Government has a variety of authorities available to it to deal with that portfolio, one of which is by ensuring that legislation makes possible successful transition to a private business over time.

2. Offset fee. The Student Loan Reform Act of 1993 requires Sallie Mae to pay the Government an annual offset fee of 0.3 percent of the loans that Sallie Mae holds that entered its portfolio since enactment of that statute. This offset fee has been estimated to generate $251 million of revenue over the next five years. In order to avoid a PAYGO issue under the Budget Enforcement Act, legislation should provide for payment in the equivalent amount by Sallie Mae to the Federal Government.

3. Exit fee. There also should be reasonable compensation to the Federal Government for the financial benefits that Sallie Mae has enjoyed as a result of its status as a GSE. Most important among these are its ability to borrow money at lower rates and to maintain much greater financial leverage (assets per dollar of equity) than private financial institutions, its exemption from state and local taxes, as well as its exemption from those taxes on the interest from its debt securities. Viewed from another perspective, the private sector needs to be assured that Sallie Mae will not have unfair competitive advantages as a private entity based on resources that it accrued as a GSE. In order to secure the ratings necessary for it to

have a reasonable chance to succeed as a private financial institution, Sallie Mae would have to meet certain capital requirements. Thus, fashioning the structure and amount of an appropriate exit fee for Sallie Mae is a difficult task. Our current thinking on the matter is explained by my colleague from the Treasury Department.

The interagency working group is in the final stages of its work; but, as I have explained, some of the very difficult issues still remain. We hope to complete the development of a specific legislative proposal for the privatization of Sallie Mae and to submit it to Congress in the near future.

I would be happy to answer any questions that you might have at this time.

Chairman MCKEON. Mr. Hough.

STATEMENT OF LAWRENCE HOUGH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE STUDENT LOAN MARKETING ASSOCIATION

Mr. HOUGH. Good morning, Mr. Chairman, and Members of the subcommittees. My name is Lawrence Hough. I am President and CEO of Sallie Mae. In my capacity, I am responsible for leading our employees in their efforts to bring reliable, high-quality services to our customers, the Nation's colleges, universities and schools, its financial institutions, and the students and their families.

Our success enables me to meet my other responsibility, that of providing a strong investment return for the many people whose savings are invested in Sallie Mae.

This morning, I would like to propose the orderly conversion of Sallie Mae from a government-sponsored entity, a GSE, to a fully private corporation. There are three compelling reasons to privatize.

Sallie Mae was created because access to student loans was very uneven across the country. Our early efforts brought liquidity to the market, that is, the ability for financial institutions to sell student loans to acquire funds to make additional loans. Since we were created, many alternatives have been added to support lenders wishing to sell or liquidate their portfolios. There are at least 42 secondary markets and a number of banks who actively purchase loans from other lenders. And, over the course of the past few years, some very large portfolios of guaranteed loans have been securitized, using the same capital markets which support the annual securitization of tens of billions of dollars in mortgage, credit card and automobile loans.

Because the market for guaranteed student loans is now mature, Sallie Mae's government-sponsored enterprise mission, to ensure a broad base of liquidity and access to student loans, is accomplished. This market no longer needs the GSE.

In the simple statement that Sallie Mae, the GSE, is no longer needed, rests a second reason to support privatization, that if reducing unnecessary borrowing with Federal backing. Notwithstanding the fact that today not a single Sallie Mae borrowing, not a single dollar of the $52 billion in debt now outstanding, carries a Federal guarantee. Investors who hold our bonds generally understand them to carry the implicit backing of the U.S. government. Sallie Mae's privatization will cleanly sever what has been for over two decades an implicit link back to the taxpayer.

Our privatization will also validate what is sometimes referred to as the life cycle of a GSE. Relinquishing GSE status is part of the life cycle. As its ending phase, privatization is achieved when the Federal GSE charter is exchanged for a State charter. Thereafter, the new entity is in a position to reduce taxpayer liability, increase State tax revenues and participate in a fully private market.

To validate the life cycle model, of course, a GSE has to successfully complete the transition. Sallie Mae is ready to chart this new path and take on this challenge. In preparation for the possibility of privatization, the corporation has worked diligently and purpose-

fully to create the strong financial balance sheet and credit standing necessary to make this transition. Our present strength was achieved through hard work, careful and prudent management, and is not merely the result of our GSE status.

There are compelling reasons to act now. There are other issues which need to be highlighted, however.

The mechanics of privatization must assure existing Sallie Mae debt holders are protected. Over the past 12 months, we have worked with the Treasury Department to develop a proposal that assures that the status and character of the debt we issue as a GSE is unaffected by privatization. Everyone acknowledges that any privatization proposal must include this protection.

You will probably ask what Sallie Mae will do when it is privatized. We plan to be there supporting the Guaranteed Student Loan Program over the long haul. Students are our core business, that is where our skills and resources have been applied with the most vigor over two decades of growth.

Three principles will guide our activities as we expand our core business. Key is building on our knowledge of the higher education industry. College administrators have told us there is significant need to be met in providing financial and technological resources to colleges and universities. We can help meet that need. Secondly, we intend to build upon the partnerships that we have today with lenders of all types and sizes. Third, we will be building upon the foundation of personnel, technology and servicing capacity that can be employed in a variety of manners to support both our higher education and lending partners.

We are currently working with Congress to solve the budget issues related to privatization. We are committed to a budget neutral proposal. We must not forget that the privatization solution we create must be acceptable to the owners of Sallie Mae, the shareholders whose investment has allowed us to accomplish our public mission. Since February, 1993, over $4 billion of investment value has been lost, and it was a shift in Federal policy that brought on this loss. It is now time to provide a path for Sallie Mae to restore the value it gave up.

Timely enactment of a proposal which rationally accomplishes the transition away from GSE status, that doesn't impose more fees on the corporation, and doesn't otherwise encumber the business will create such a path, and again signal encouragement to future investors.

Sallie Mae shareholders are well aware that there are alternatives to our privatization proposal. One is for Sallie Mae to continue as it is. I do not believe this is a viable option at this time. Another option which we have considered and turned aside for now, but has recently been publicized by a group of dissident shareholders, would be break Sallie Mae into parts, selling off the most valuable divisions.

The plan I propose calls for orderly change. I strongly believe that it is in the best interest of shareholders.

In summary, the time is right for Congress to provide Sallie Mae with the opportunity to privatize in an orderly way. Privatization will both assure our continued support for the Guaranteed Student

Loan Program and allow our employees to apply their skills and resources in other ways which will benefit America.

Thank you. I'd be happy to answer questions.

Chairman MCKEON. Thank you.

[The prepared statement of Mr. Hough follows:]

Lawrence A. Hough

Good Morning, Mr. Chairman and Members of the Subcommittees.

My name is Lawrence Hough. I am the President and Chief Executive Officer of the Student Loan Marketing Association (Sallie Mae), a position I have held for approximately five years. I joined Sallie Mae in its founding year.

This morning I would like to propose the orderly conversion of Sallie Mae from a government sponsored entity to a fully private corporation.

In my testimony today, I will concentrate on four key points:

1. Sallie Mae is a successful public/private partnership that has accomplished its mission and has done so with as little reliance on its government ties as possible. For all intents and purposes, Sallie Mae has conducted itself as a fully private corporation for the past decade or more. Sallie Mae is now poised to move away from government sponsorship to the next stage of its life cycle.

2. Sallie Mae remains committed to supporting the Federal Family Education Loan Program (FFELP). That is our core business, and we have no intent to change that.

3. Sallie Mae can add a great deal of value to the constituents it now serves -- schools, students, parents, lenders -- if it is free to use its technological, financial, and transaction processing expertise in new and important ways.

4. To burden a privatized Sallie Mae with unnecessary fees is in no one's best interest.

The Case for Privatization

There are three compelling reasons to privatize Sallie Mae.

We Have Accomplished Our Mission. Sallie Mae was created by of the Education Amendments of 1972 because access to student loans was very

uneven across the country. Loan volume then was around $1 billion a year. Today, the picture is completely different. As you well know, the FFELP and the Federal Direct Student Loan Program (FDSLP) now provide over $25 billion in student financial aid each year. Private capital has made education loans to over 22 million students and parents. Over $80 billion in private capital is now invested in FFELP loans. Many lenders have the largest portfolios of student loans in their history. Across the nation, thousands of lenders continue to offer student loans as part of their retail banking services. Participation is strong -- among both large and small lenders. Sallie Mae was instrumental in fostering this expansion of the FFELP.

Since Sallie Mae offered the first significant source of liquidity to lenders holding guaranteed loans in 1974, the FFELP industry has added many alternatives for those lenders wishing to sell or liquidate their portfolios. There are at least 42 secondary markets and a number of banks who actively purchase loans from other lenders. And, over the course of the past few years, some large portfolios of FFELP loans have been securitized, using the same capital market structures which support the annual securitization of tens of billions of dollars in credit card,

automobile, and mortgage loans. Since the FFELP market is mature, with a very healthy set of liquidity choices for its participants, Sallie Mae's mission -- to ensure a broad base of liquidity for and access to student loans -- is accomplished. The FFELP market no longer needs a government sponsored enterprise (GSE).

Reduces Government Liabilities. In the simple statement that Sallie Mae -- the GSE -- is no longer needed . . . rests a second reason to support privatization: reducing unnecessary borrowing with federal backing. Notwithstanding the fact that not a single Sallie Mae borrowing, not a single dollar of the $52 billion in debt now outstanding, carries a federal guarantee, investors who hold these bonds generally understand them to carry the "implicit" backing of the U.S. Government. Sallie Mae's $52 billion debt is part of what you have all heard referred to as "off balance sheet" federal liability -- the piece of the overall taxpayer exposure which is not included in the national debt statistics. Sallie Mae's privatization cleanly severs what has been for over two decades an implicit link back to the taxpayer.

Completing the GSE Life Cycle. Sallie Mae's privatization will validate what is sometimes referred to as the "life cycle of a GSE". Relinquishing GSE status is part of the "life cycle". It also will reduce taxpayer liability, increase state revenues, and create a fully private market.

To establish the "life cycle" model, a GSE has to successfully complete the transition. Sallie Mae is ready to chart this new course and take on the challenge. Sallie Mae's Management and Board of Directors over the past several years have kept the concept of privatization among the issues considered in setting our strategic course. In preparation for the possibility of privatization, the corporation has worked diligently and purposefully to create the strong financial balance sheet and credit standing necessary to one day achieve the transition. Our present strength was achieved through hard work and careful management, and is not the result of our GSE status.

These are the compelling reasons to act now to privatize Sallie Mae. There are other issues which need to be highlighted however.

Protection of Existing Bondholders. The mechanics of privatization must assure that existing Sallie Mae debtholders are protected. Over the past twelve months we have worked with the Treasury Department to develop a privatization proposal that assures that the status and character of the debt we issue as a GSE is unaffected by privatization. Everyone acknowledges that any privatization proposal must include this protection.

Business Lines. You probably will ask what Sallie Mae will do when it is privatized. First and foremost, Sallie Mae will continue to support the FFELP. Sallie Mae plans to be there supporting the student loan program, over the long haul. Student loans are our core business: that is where our skills and resources have been applied with the most vigor over our two decades of growth. We fully expect to maintain a strong presence in the student loan marketplace, to continue to develop innovative ways to streamline the administration of student loans, to investigate and create new ways to lower the cost of borrowing for students and parents, to provide superior counseling and customer service to our borrowers and to continue our successful facilities finance business. To do otherwise, to abandon our core business line, would serve no one's interest -- neither our school and

lending partners, our employees, nor our shareholders. In addition, our proposed structure ensures that Sallie Mae will still be available as a lender of last resort during the gradual and orderly phase-out of the GSE.

Three principles will guide our activities as we expand on our core business. Key, is building upon our knowledge of the higher education industry. We believe there is a significant need to be met in providing financial and technological resources to colleges and universities, and we have confirmed that need in meetings with and surveys of college administrators. Second, we intend to build upon the partnerships that we have today with lenders of all types and sizes. Third, we will be building upon a foundation of personnel, technology, and servicing capacity that can be employed in a variety of manners to support both our higher education and our lending partners.

Budget Neutrality. As we have considered privatization and entered serious discussions with the Administration, interested Members of Congress and Senators, we have been faced with the fact that, once again, budget scoring rules may be the key to the corporation's future. In 1993,

in an attempt to meet the scoring target for budget reconciliation, a 30 basis point "offset fee", a tax, was imposed on all new loans owned by the corporation. Any expected revenue from the fee lost through privatization will need to be offset. Unfortunately, no credit is given for the principal benefit to the government -- reduced federal liabilities. We are working with the Committees of the Congress to solve these budget scoring issues.

Shareholder Concerns. We must not forget that the privatization solution we create must be acceptable to the owners of Sallie Mae - the shareholders whose investment has allowed us to accomplish our public mission. Shareholders are well aware that there are alternatives to our privatization proposal. One is for Sallie Mae to continue as it is -- I do not believe this is a viable option over time. Another option which we have considered and turned aside for now -- but has recently been publicized by a group of dissident shareholders -- would be to break Sallie Mae into parts, selling off the most valuable divisions. The plan I am proposing calls for more orderly change. I strongly believe that this plan is in the best interest of Sallie Mae's shareholders.

I am hopeful that this Congress can approve a privatization proposal that will be supported by our shareholders. The shareholders of Sallie Mae are investors - real people, and firms who manage people's retirement savings. They also include many mutual funds who invest the savings of millions of Americans, and the endowments of many colleges and other non-profit organizations. Since February 1993, over $4 billion of investment value in Sallie Mae has been lost. This constitutes a heavy "fee" that shareholders have already paid. Timely enactment of a proposal which rationally accomplishes the transition away from GSE status, that doesn't impose more fees on the corporation, and doesn't otherwise encumber the business, will validate their investment in this public/private partnership.

In summary, the time is right for the Congress to privatize Sallie Mae in an orderly way. Privatization will both assure our continued support for the FFELP and allow us to apply our skills and resources in other ways which will benefit America.

Thank you. I would be happy to answer any questions.

Mr. McKeon. Mr. Sockwell.

STATEMENT OF OLIVER SOCKWELL, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE COLLEGE CONSTRUCTION LOAN INSURANCE ASSOCIATION

Mr. Sockwell. Thank you, Mr. Chairman, and, Members of the subcommittees. I appreciate this opportunity to acquaint you with the history and accomplishments of Connie Lee, as well as to discuss the rationale for privatization.

By way of introduction, Connie Lee was authorized by Congress to help finance the $100 billion demand for new and renovated higher education facilities. America was falling behind not only in adequate classroom buildings, but also in laboratories, scientific equipment, libraries and student housing. The Congress determined that long-term, low-cost debt financing was the only realistic solution that could provide the billions necessary on a nationwide basis. However, because commercial lenders and individual investors were not at that time comfortable with the unique accounting and non-profit status of colleges and teaching hospitals. Congress concluded, therefore, that some sort of government program was needed to make sure long-term financing would be made available.

Here's where the story gets interesting. Congress decided not to take the easy route and create another expensive federally guaranteed loan program. Nor did they create a traditional government-sponsored enterprise, which would have meant billions of dollars of new Federal debt to be relent in competition with the Nation's banking system. Rather, Congress authorized Connie Lee to be a State-chartered private corporation, which insures and reinsures repayment of moneys borrowed by colleges and hospitals. As a financial guarantee company, Connie Lee operates more efficiently than a traditional GSE, and the only Federal financial involvement is as a minority shareholder, one among the 30 investors in Connie Lee.

From inception in 1988 through today, Connie Lee has insured and reinsured approximately $10 billion of principal and interest for academic facilities financings. It should be noted that this has been done with no claims or defaults to date. Connie Lee's insurance increases investor demand for the institutions' bonds and lowers the interest costs, saving millions of dollars.

It's important to note that Connie Lee's main constituency includes primarily the smaller and less well-known institutions, both public and private, however, which are stepping stones to opportunity and upward mobility in our country. To name just a very few: Widener University in Pennsylvania, Berkshire and Middlesex Community Colleges in Massachusetts, Whittier College in California, University Medical Center in Florida, Valparaiso University in Indiana, and Incarnate Word College in Texas. Among historically Black colleges and universities, we have recently offered commitments to Clark Atlanta University, as well as the University of the District of Columbia.

Perhaps most important, Connie Lee's successful track record has not gone unnoticed. Since Connie Lee became operational, large investors and insurers have directed more than $50 billion of long-term capital into academic facilities financing.

With this record of apparent success, several questions seem obvious. First, why would Connie Lee seek privatization? Second, why should Congress change anything? And, finally, and, perhaps, most important, can Connie Lee function and profit without Federal support? Let's address the last question first—Connie Lee's ability to stand alone. Unlike other GSEs, Connie Lee does not rely on a line of credit to the U.S. Treasury, nor does Connie Lee use federally-backed debt to fund its operations. However, I do want to be clear that Connie Lee does pay District of Columbia taxes.

Let's discuss what the Federal Government achieves by privatizing Connie Lee, which would be accomplished primarily through the sale of the government's equity interest. This would return money to the U.S. Treasury, and upon privatization the government appointed board members would be replaced by directors elected by shareholders. These actions would remove the basis for claims of an implicit Federal obligation for our guarantees.

Now, to the third issue. Why does Connie Lee desire privatization? For that, I'd like to reference a definition of GSEs by Tom Stanton, author of "A State of Risk," the first book to provide a detailed examination of GSEs. Stanton defines a GSE, and I quote, as a "private corporation which accepts being limited to a certain business in return for government support." He goes on to note, however, that there is a danger: That the lack of flexibility to react and change with the overall economy and business environment may not be sufficiently offset by the government's support.

We all underestimated the volatility of the economy and the Nation's credit markets, so Connie Lee has proven to be an example of what Stanton warned about, a fundamental lack of balance between the degree of Federal support and the degree of Federal restriction on our business activities. As we've discussed, the government's direct financial support of Connie Lee is minimal, but on the other hand the government-mandated mission is clearly the most restrictive of any GSE. This makes it less likely that private investors will choose to provide more capital when we need it. Inability to raise money in the private equity capital markets could force Connie Lee to petition the Federal Government for additional financial support. Some officials have also expressed concern that should the Federal restrictions ultimately result in the inability of Connie Lee to meet its guarantee obligations, holders of Connie Lee insured securities might, themselves, directly seek redress from the Federal Government.

In summary, what Connie Lee achieved through privatization is the flexibility to expand its markets so as to stabilize its revenue stream, assure its continuing health and financial strength, and provide an acceptable return to equity investors. Through privatization, we can maintain the original higher education mission without requiring additional government support.

I hope this discussion will encourage you to support the full privatization of Connie Lee. Thank you. I'll be pleased to answer your questions.

Chairman McKeon. Thank you much for your statements.

[The prepared statement of Mr. Sockwell follows:]

STATEMENT OF OLIVER R. SOCKWELL
PRESIDENT AND CHIEF EXECUTIVE OFFICER
COLLEGE CONSTRUCTION LOAN INSURANCE ASSOCIATION
(CONNIE LEE)

Mr. Chairman and Members of the Subcommittees:

I appreciate this opportunity to acquaint you with the history and accomplishments of Connie Lee, as well as to discuss the rationale for privatizing Connie Lee.

By way of introduction, Connie Lee was authorized by Congress under Title VII of the Higher Education Act of 1986 to help finance the $100 billion demand for new and renovated higher education facilities. America was falling behind not only in adequate classroom buildings, but also in laboratories, scientific equipment, libraries and student housing. The Congress determined that long-term, low cost debt financing was the only realistic solution that could provide the billions necessary on a nationwide basis. However, because commercial lenders and individual investors were not comfortable with the unique accounting and non-profit status of colleges and teaching hospitals, only about one in ten had been able to access the public debt markets. Congress concluded, therefore, that some sort of government program was needed to make sure long-term financing would be made available.

Here is where the story gets interesting. Congress decided not to take the easy route and create another expensive federally guaranteed loan program. Nor did they create a traditional government sponsored enterprise -- which would have meant billions of dollars of new federal debt to be re-lent in competition with the nation's banking system. Rather, Congress authorized Connie Lee to be a state-chartered

private corporation, which insures and reinsures the repayment of monies borrowed by colleges and hospitals. As a financial guarantee company, Connie Lee operates more efficiently than a traditional GSE. The primary federal financial involvement is as a minority shareholder -- one among the 30 investors in Connie Lee. Specifically, the Department of Education owns less than 15 percent of Connie Lee, and appoints four of our eleven directors (Table I).

Because the company's federal ties are minimal, it receives less special consideration from Wall Street than other GSE's. For example, Connie Lee earned its "AAA" rating from Standard & Poor's based entirely on its prudent underwriting and capital adequacy.

From inception in 1988 through today, Connie Lee has insured and reinsured approximately $10 billion of principal and interest for academic facilities financings. Connie Lee's insurance increases investor demand for the institutions' bonds and lowers the interest cost, saving millions of dollars. And, because the financing is guaranteed, repayment can be spread over a longer term, preserving even more cash for current expenses.

It is important to note that Connie Lee's main constituency includes comparatively small and less well-known institutions, both public and private, which are stepping stones to opportunity and upward mobility. To name just a very few: Widener University in Pennsylvania, Berkshire and Middlesex Community Colleges in Massachusetts, Whittier College in California, University Medical Center in Florida, Valparaiso University in Indiana, and Incarnate Word College in Texas. Among historically black colleges and universities, we have recently offered commitments to Clark Atlanta University, as well as the University of the District of Columbia.

Perhaps most important, Connie Lee's successful track record has not gone unnoticed. Large investors and insurers have directed more than $50 billion of long term capital into academic facilities in the last five years.

With this record of apparent success, several questions seem obvious: First, why would Connie Lee seek privatization? Second, why should Congress change anything? Finally, and perhaps most important, can Connie Lee function and prosper without federal support? Let's address the last question first -- Connie Lee's ability to stand alone. Unlike other GSE's, Connie Lee does not rely on a line of credit to the U.S. Treasury; nor does Connie Lee use federally backed debt to fund its operations. However, I do want to be clear that Connie Lee does pay District of Columbia taxes. Furthermore, because we are a state-chartered insurance company, Connie Lee already meets regulatory requirements for solvency, capital and reserves -- just like any private insurance company. So you can see we are fully prepared -- ready, willing and able -- to be privatized.

Let's discuss what the federal government achieves by privatizing Connie Lee. Privatization would be accomplished primarily through the sale of the government's equity interest in Connie Lee. And, just like any other asset sale, this would return money to the US Treasury. Upon privatization, the government appointed board members would be replaced by directors elected by shareholders and the federal statute which dictates the company's business operations would be repealed. These actions would remove the basis for claims of an implicit federal obligation for Connie Lee guarantees.

Now, to the third issue. I suspect that some of you are still a bit confused as to why Connie Lee itself desires privatization. To begin, it is useful to define just what a government sponsored enterprise is. For that, I'd like to reference Tom

Stanton, author of "A State of Risk," the first book to provide a detailed examination of GSE's. Stanton defines a GSE, and I quote, as a "private corporation which accepts being limited to a certain business in return for government support." Stanton goes on to note, however, that there is a danger: That the lack of flexibility to react and change with the overall economy and business environment may not be sufficiently offset by the government's support.

If anything, Stanton underestimated the volatility of the economy and the nation's credit markets. We all did. So, Connie Lee has proven to be an example of what Stanton warned about -- There is a fundamental lack of balance between the degree of federal support and the degree of federal restriction on our business activities. As we have discussed, the federal government's direct financial support of Connie Lee is minimal - $19 million out of a total of $137 million of start-up equity capital. On the other hand, Connie Lee's government mandated mission is clearly the most restrictive. As an example, Federal law prevents Connie Lee from guaranteeing stronger credits so as to balance the marginal institutions. Federal law prevents the company from covering the higher expense of underwriting colleges with revenues from other activities. Federal law prevents Connie Lee from reacting to changes in the business environment in the same timely fashion as other bond insurance companies. None other than the Congressional Budget Office noted the company's dilemma in a 1993 report that said, and I quote, "At present, it is unclear whether Connie Lee will be sufficiently profitable operating only in this relatively high-risk segment of the bond insurance market." Perhaps the CBO recognized that while state insurance regulators require that Connie Lee maintain the same high level of paid in capital as fully private companies - the federal government restrictions on our business activities severely limit our ability to put that capital to full use - as

markets have come to evolve so rapidly. As a result, Connie Lee has a lower return on equity than any other bond insurance company or GSE. This makes it less likely that private investors will choose to provide more capital at an affordable price when we need it. Inability to raise money in the equity capital market could force Connie Lee to petition the federal government for additional financial support. Some officials have also expressed concern that -- should the federal restrictions ultimately result in the inability of Connie Lee to meet its guarantee obligations, holders of Connie Lee insured securities might themselves directly seek redress from the federal government.

In summary, what Connie Lee achieves through privatization is the flexibility to expand its markets so as to stabilize its revenue stream, assure its continuing health and financial strength, and provide an acceptable return to equity investors. Through privatization, we can maintain the original higher education mission -- without requiring additional government support. In fact, the one potential question the Congress should not concern itself with is whether, as a fully private company, Connie Lee will continue to serve higher education. Let me assure you that education facilities are what we know best and will always be our "core" business. Privatization will free us to accommodate a broader universe of educational institutions through a wider variety of services that we can now under the federal legislation.

In closing, I'd like to emphasize that the privatization of Connie Lee reduces federal interference in the credit markets and reverses federal intrusion into the state regulated insurance industry. A privatized Connie Lee will apply its unique underwriting expertise to help rebuild America. We will provide insurance to support financings for higher education, but also to support financings for many

other kinds of infrastructure -- elementary and secondary school construction, housing, transportation, water and sewer system financings, etc. Just as with colleges and hospitals, our specialty will be the less well known and more complex projects which are sometimes overlooked by traditional institutions. And let's remember that approximately 50,000 jobs flow from every billion dollars of new infrastructure.

I hope this discussion will encourage you to support the full privatization of Connie Lee. We are appreciative of your support to date and look forward to new challenges and opportunities in the future. Thank you. I will be pleased to respond to your questions.

Table I

Government-sponsored Enterprise Links to the Federal Government

Feature	Federal National Mortgage Association	Federal Home Loan Mortgage Corporation	Federal Home Loan Banks	Farm Credit System	Federal Agricultural Mortgage Corporation	Student Loan Marketing Association	College Construction Loan Insurance Association
Chartered by Act of Congress	Yes	Yes	Yes	Yes	Yes	Yes	No
Ownership	Private	Private	Private	Private	Private	Private	Federal & Private (a)
President or presidential appointees appoint some board members	Yes (5/18)	Yes (5/18)	Yes (6/14) (b)	No	Yes (5/15)	Yes (7/21)	Yes (4/11)
Treasury lending authorized	$2.25B	$2.25B	$4.0B	No (c)	$1.5B (d)	$1.0B	No
Treasury approval of debt issuance	Yes	Yes	Yes	No	No	Yes	No
Eligible for Fed open market purchases	Yes	Yes	Yes	Yes	n/a (e)	Yes	No
Use of Fed as fiscal agent	Yes	Yes	Yes	Yes	Yes	Yes	No
Eligible to collateralize public deposits (all US Government; most State & local)	Yes	Yes	Yes	Yes	No	Yes	No
Exempt from SEC registration (1933 Act)	Yes	Yes	Yes	Yes	No	Yes	No
Government securities for purposes of the Securities Exchange Act of 1934	Yes	Yes	Yes	Yes	Yes	Yes	No
Eligible for unlimited investment by national banks and State bank FR members	Yes	Yes	Yes	Yes	Yes	Yes	No
Eligible for unlimited investment by thrifts regulated by FDIC or OTS	No	No	Yes	Yes (f)	No	No	No
Exemption of corporate earnings from Federal income tax	Yes	Yes	Yes	Yes	No	Yes	No
Exemption of corporate earnings from State and local income tax	No	No	Yes	Yes	No	Yes	No
Exemption of interest paid from State income tax	Yes (g)	Yes (g)	Yes	No	Yes	No	No
Subject to GAO audit	HUD	HUD	FHFB	FCA (h)	FCA	None	None
Federal regulator							

(a) Federally-owned stock may be sold after five years from date of incorporation.
(b) Each bank.
(c) Treasury is authorized to guarantee up to $4 billion of Financial Assistance Corporation bonds.
(d) Upon required certification from FASIC, borrowing from Treasury authorized to make payments under guarantee.
(e) Entity newly created.
(f) Federal Land Banks, Farm Credit Banks and Financial Assistance Corporation.
(g) Mortgage transactions may be subject to GAO audit under rules that may be prescribed by the Comptroller General.
(h) The Farm Credit System Assistance Board also has certain powers with respect to the Financial Assistance Corporation and the System institutions needing financial assistance.

Source: Statutes and regulations pertaining to the GSEs.

Chairman MCKEON. We'll open it up for questions.

Mr. Gunderson.

Mr. GUNDERSON. Thank you very much, Mr. Chairman.

I think we find ourselves today with a generally good idea on which there is a consensus, but like with so many things the devil is in the details.

My first question focuses on the offset fee. You, Mr. Kornfeld, suggested it was $250 million, I'm told, the Congressional Budget Office suggests it is $585 million. How do we figure out what the number is?

Mr. KORNFELD. Well, I'll have to look into it, Mr. Gunderson.

The offset fee, as you know, is a .3 percent offset fee that Sallie Mae is required by law to provide to the Federal Government. Our estimate over the next five years is that would—that offset fee would generate income to the Treasury of $250 million. If the Congressional Budget Office has another number, I will look into it and get back to you and determine the difference.

Chairman MCKEON. Will you please move the mike a little closer there, for the record.

Mr. KORNFELD. I'm sorry.

Should I repeat? Did you not hear my answer?

Mr. GUNDERSON. I heard you, I don't know if the record did or not. The record is fine, okay.

Mr. KORNFELD. That's okay, fine.

Mr. GUNDERSON. Anybody else who has got a question can call the Chairman and he'll repeat what you said.

I mean, those are pretty big differences.

Mr. KORNFELD. Yes.

Mr. GUNDERSON. And, I think we've got to resolve that if we are going to move in this direction.

Mr. KORNFELD. And, we will get back to you, Mr. Gunderson.

Mr. GUNDERSON. My bigger problem in dealing with this issue, however, is that I think we are sitting at a table today with unrealistic visions of the future. Obviously, the Department knows, and the administration knows, that we are not going to go to 100 percent direct lending. There is simply no chance that this Congress will move in that direction, so that's not going to happen. Obviously, most people are aware that we are considering something called elimination of in-school interest subsidy. My name is not listed as a cosponsor of that initiative, but I'm well aware that that's something we've got to look at and may have to deal with.

I tell you all this because I'm trying to figure out what all this means down the road. If we are, indeed, dealing with $25 billion a year in loan level among college students today, and if the Department projects that that's going to go up to $34 billion by 1999, and that is under present assumptions, I'm sure that does not include an in-school interest subsidy being eliminated, that means they were going to add some real money to that, probably, I understand, about $2 billion to $2.5 billion a year at a minimum.

Now, what this tells me is that we are looking at dramatic increases in student debt. We are also looking at eliminating a secondary market, that has an obligation to take this debt, and I've got to ask both the administration and Mr. Hough, where's this service to the students going to come from? I mean, I don't see any

incentive for the local banks in western Wisconsin, without a secondary market, without in-school interest subsidy, would very likely increase the default rates because students' debt load is so high that they simply can't meet it. I can see a real crisis in capital, and nobody has assured me this morning that that scenario won't play out.

Mr. KORNFELD. We share your concern, Mr. Gunderson. As you know, 7 million persons took out loans this year, $25 billion, as you point out, that's more than 55 percent of every person who attended postsecondary education has taken out a loan.

As you point out, too, every estimate, be it our Budget Office, CBO, whoever, is estimating that that loan volume will keep increasing over the years.

As you know, Sallie Mae, 70 percent of all the loans in this country are sold by lenders to secondary markets, Sallie Mae purchases about half of those loans. If a lender cannot, since so much of the volume is sold, if a lender cannot sell the loans they are just not going to provide the loans and, therefore, our concern is exactly as your's is.

Mr. GUNDERSON. You are supporting this, it's access.

Mr. KORNFELD. We're supporting privatization, but we have to make sure that it has certain conditions that continue to provide access. For example, if Sallie Mae were a private company, we have major concerns as to whether the remainder of the secondary market companies in this country could fill the gap.

As you know, secondary markets have already issued $17 billion of tax free bonds to buy these bonds. Those tax free bonds cost the Federal Government $1 billion. And, if Sallie Mae is going to go private, if the Congress determines that that's the best, in our legislation we are going to propose certain ways to ensure that that access continues and that we continue making sure that those loans that lenders are selling still provide, still have a market to be sold. Clearly, what will happen is, as the loan volume increases in guaranteed student loans, and as the loan volume of the direct loan increases, there will be a different kind of mix here, and what we want to make sure is, and what we are working on and which will be part of our legislation, to ensure that if Sallie Mae is a private company that we do provide certain conditions in there.

Mr. GUNDERSON. You want to eliminate the GSE status but keep all the mandates.

Mr. KORNFELD. Well, we want to make sure that there still remains access, and we don't want to manage——

Mr. GUNDERSON. Well, call it what you will. I need to hear from the other side on this.

Mr. HOUGH. Thank you, Congressman Gunderson.

I'd be very pleased to answer the question, because it lies at the heart of my earlier testimony. There is no question that this company's expertise is in buying student loans. We will buy student loans, as far as I can imagine looking out into the future, with the same kinds of support from private capital, with the same expertise that servicing brings and enables us to buy virtually unlimited quantities of student loans in any economic conditions.

As I noted in my remarks, there are a large number of alternative sources. There is far more diversity, and with that diversity

today there is far less risk that capital will be there for the students of the next generations.

Sallie Mae will be part of that capital support, but so will be some of the Nation's largest banks. There is no evidence of any kind, even though the yields through legislative reductions have dropped, that the Nation's lenders are withdrawing their support from this program.

I would point to the very strong successes of National City, of Pittsburgh National, of Chemical, of Fleet, of Citicorp, of Wells Fargo. Regionally, nationally, there is strong lender support.

Sallie Mae, from its perspective, has worked very hard to ensure that the smaller institutions, the heartland banks, continue to have access to this market and are, in fact, very aggressive in their own support with the colleges and universities in their regions. That support will continue.

We, and other players in this industry, are making it easier today by absorbing some of the intensely complex back-room processing to enable them to concentrate on what they are best at, finding the market, providing the capital and originating the credit. Secondary markets and lenders who buy loans stand ready to meet all foreseeable demand, regardless of the level of the Direct Loan Program.

Privatization of this corporation will not impede, in any respect, our ability to meet that demand going forward. I couldn't emphasized that point more strongly.

Mr. GUNDERSON. Thank you, Mr. Chairman.

Chairman MCKEON. Thank you.

Mr. Williams.

Mr. WILLIAMS. Thank you.

Mr. Hough, you had said in your testimony that you intend to be there for the long haul serving students. Would you propose language to the legislation to mandate that you stay there for the long haul serving students?

Mr. HOUGH. We have shared with Members specific language that gives a strong indication on our part to so do. I'm not familiar with the exact wording, but, in effect, it says if there are student loans being made in the future, Sallie Mae will buy them.

Mr. WILLIAMS. And, Mr. Sockwell, with regard to your original mission, would you support legislatively requiring Connie Lee to maintain its original mission, while broadening the commercialization possibilities?

Mr. SOCKWELL. What's been discussed is legislation that would require Connie Lee's Articles of Incorporation to state that we would continue to support higher education.

Mr. WILLIAMS. Again, to both of you, one of the matters that the Members of the committee hear from the public and from the potential competitors of your's, as well as some of your shareholders, is wondering what type of business either of your groups would pursue if you were privatized or commercialized. Can you give us an idea?

Mr. HOUGH. Certainly, Congressman Williams. It is a question that has been raised, and I think there's been speculation that I would be happy to address at this time.

Our company has worked very hard with special emphasis over the last two years, recognizing that as this industry has changed the critical component of aid delivery is the college and university and the lenders in partnership with us and other secondary markets, now are defining their jobs much more closely with meeting the needs of colleges and universities.

And, it's through that relationship today that we meet the needs of students and families. Our future will be based on developing new ways to ensure that as we reach out to colleges and universities, they will find in us a source of support and services that made up our resources, the skills of our people with their needs.

In our discussions with university administrators, we've been very encouraged to pursue new products and services that help them reduce the administrative costs in ways, for example, like outsourcing some of their services, and developing computer systems that support the delivery and the smoother and less costly administration of the student records part of their academic mission. That's just one indication. I would also suggest that through the skill of our 4,000 employees, who work in the area of processing and the technology that supports that processing, we are very optimistic that there are other ways for us to harness their capacities in over, perhaps, the time of a decade, moving in a positive way into new businesses. One area in particular that we've looked at is the administration of consumer interactive, heavily regulated businesses like, for example, health care.

That would be how I'd choose to answer the question, sir.

Mr. WILLIAMS. Mr. Sockwell?

Mr. SOCKWELL. Congressman Williams, the first point I would make is that privatization would allow Connie Lee to help even more colleges and universities. The Federal legislation currently limits Connie Lee to approximately 20 percent of the colleges and universities in this country, so we'd be able to address the needs of a much broader spectrum of colleges and universities, and, particularly, among historically Black colleges, the State colleges, under our current legislation we have a lot of difficulty in addressing their needs.

The other thing that we would do is support financing for different types of infrastructure, elementary and secondary school construction, roads, other types of transportation, housing, water and sewer system financings, particularly in rural areas. We think that we have a special expertise in more complex transactions, smaller transactions that are frequently overlooked by the major financial houses. And so, our specialty would again be the less well-known and more complex projects.

And, one of the things that we have considered in that regard, in considering a focus on infrastructure, is the administration's statement that approximately 50,000 jobs flow from every billion dollars of new infrastructure. So, we think that we can play a larger service to education, as well as to the Nation in general, under privatization.

Mr. WILLIAMS. Finally, Mr. Chairman, I would just note, Mr. Sockwell, that a number of Members on the Democratic side are extremely interested in your last—will be extremely interested in your last statement, because they want to be assured that the

achievement of Connie Lee's original mission, would be enhanced by commercialization of Connie Lee. It's the original mission of serving the needs of Black colleges, under-financed colleges. This side is dissatisfied with the service that Connie Lee has provided to those groups, and we'd want to be sure that service is enhanced and that objective finally met, not diminished.

Thank you, Mr. Chairman.

Chairman MCKEON. Thank you.

Ms. Bradbury, Mr. Kornfeld, as you know, we've been working on a proposal for privatizing Sallie Mae based on many of the points outlined in your testimony.

Obviously, now, you've given a great deal of thought to this. It would be very helpful if you were to review our proposal and provide technical advice which you think would improve it. Would you be agreeable to providing such advice in the next few days, if I forward copies to you?

Ms. BRADBURY. Treasury would be happy to help you and your staff in any way possible.

Mr. KORNFELD. We would welcome the opportunity to work with you, Mr. Chairman, to accomplish that task.

Chairman MCKEON. Thank you. We'll get that to you, because we do want to move quickly on this process.

I notice in your testimony, you mentioned an exit fee in the context of Sallie Mae privatization, but not in the context of Connie Lee. Is this a policy difference due to the type of GSE, or is it an economic decision, or is there some other reason for treating them differently? Would an exit fee be a consideration if we were talking about the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation?

Ms. BRADBURY. I'm not sure I can comment on Fannie Mae and Freddie Mac privatization, because the issues there are somewhat different in terms of their market, and I have not been personally involved in looking at those.

But, we do believe that the Federal Government's relationship with Sallie Mae and Connie Lee is different, and, in particular, the Federal Government would be selling its Connie Lee stock, and we would want to work closely with Connie Lee to make sure that that was done in a way that was advantageous for both of us. We both benefit from the highest price possible, so in a sense we will be getting funds from that privatization.

In the Sallie Mae situation, our first priority is to make the legislation revenue neutral. Mr. Gunderson raised some issues in that area. In particular, that's very important given both Congress' and the administration's commitment to deficit reduction at this point.

In addition, though, we felt that it was appropriate to, perhaps, benefit from the future success that we wish Sallie Mae has, and so, we thought we needed to give some certainty to shareholders so we wouldn't have an unlimited draw on their future resources, and we've not developed a specific proposal of how to do that, but one possibility is the warrants I described to you. Those were used rather successfully in the Chrysler Corporation situation that a lot of us at Treasury have experience with.

Mr. KORNFELD. Connie Lee, the reason for the difference in our opinion, too, is that Connie Lee is less federally connected. Fun-

damentally, in an over-simplified way, what the government did for Connie Lee is provide some prime pump money up front to get the started, and as a result the government now owns, I believe, it's about 14 percent of the Connie Lee stock.

In the case of Sallie Mae, there's a major difference. In the case of Sallie Mae, the financial benefits that Sallie Mae obtained was through the GSA, where they had specific advantages over their competitors, and really helped—the GSA category for Sallie Mae helped them become the company that they are today. And, therefore, we do feel that there is some compensation due to the government.

Chairman MCKEON. Thank you.

Mr. Hough, do you have a comment on that?

Mr. HOUGH. Yes. I have quite a different view than that that Mr. Kornfeld just articulated. My view is very well in line, however, with the view of our regulator, as represented by Ms. Bradbury.

The heart of the issue here is the question of what it takes to successfully start the GSE, and that takes investor confidence. And, issues that discredit the work of management in compiling a record that has earned the corporation, as we have done, the credit it has, and standing we enjoy in the debt markets, and the credit we should be recognized for in bringing this company to the point where it could be successfully privatized, is a full honoring of the pact that we have with the Federal Government.

Companies owned by its shareholders, significant exit fee would be tantamount to presenting the situation in which the shareholders would not agree to privatization after the legislation had been enacted. In that point of view rests the strength of the Treasury proposal, because as Treasury has so well set it forth, as a privatized company we are sure that we will build new value and restore new value to the shareholders, having lost it over the last 24 months.

Treasury's observation is merely to share, in a modest way we hope, in the value that that stock receives in the years ahead. The nature of a warrant is a nature that our management and board would specifically be pleased to continue to work with Treasury to work out, and I think there's a good likelihood that I could bring it with full support of our board to the shareholders when, ultimately, they make that decision.

I think that's how I would like to frame this issue, and having those specific points in contrast with Mr. Kornfeld's.

Chairman MCKEON. Thank you. My time is gone.

Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman.

I would like to thank the committee for having the joint hearing today. I'm not actually on the Subcommittee of the Government Reform and Oversight, but I am on the full committee, and on the Education Committee. The subcommittee, and the Ranking Member, Mr. Williams, have raised the same concerns that I have on Sallie Mae and Connie Lee which is the original mission. Sallie Mae was for a secondary market, and knowing that we want it still available, whether we are at 40 percent this year, which we are, or 50 percent, or whatever, and depending on what this committee

and Congress may do. So, I was glad to see the emphasis would still be there.

And, again, Connie Lee was created in 1986 with a purpose for smaller colleges who couldn't go to the open market. We're going to have to adjust to see how your mission can continue and still be privatized.

For the Treasury and Education Department, I have some specific questions. One of the issues we've considered is the privatization of both these agencies, Sallie Mae and Connie Lee, and what price should we expect for such privatization. Are we actually looking at benefiting the Treasury, and if you all could address that, and also, Sallie Mae's privatization direct lending are separate issues, are they linked somehow in considering what we know was passed in 1993 on the reconciliation package, and what has been introduced, as my colleague, Mr. Gunderson, has talked about.

That's it.

Ms. BRADBURY. Let me just comment briefly on your second question, the direct lending. I think we view the privatization of Sallie Mae as a natural consequence of the direct lending program that Congress and the administration embarked on, and so we do view them as linked and we are developing our privatization proposal assuming that the current law will be there and that we'll have continued expansion, as is authorized under the current law.

Secondly, on the issue of fees, what we have suggested is that Connie Lee, we own shares, we would like to sell those shares. We would like to get the highest price possible for the taxpayers, and that money would be returned to the U.S. Treasury, and that would sever our financial relationship with Connie Lee.

On Sallie Mae, the first issue is revenue neutrality of the bill. We cannot have an impact on the deficit out of this proposal, so first and foremost we want to ensure that the bill is revenue neutral.

In addition to that, we have suggested that the U.S. government could share in any possible future success that Sallie Mae might have, perhaps, through warrants or some other mechanism that would allow us to benefit from the growth and profitability that they believe they'll have as a private company.

Mr. KORNFELD. As Congressman Gunderson pointed out, the devil is only in the details, and although we certainly support privatization as a concept, the problem is, as you get into it in detail the problem gets very complex, and it does provide us with some concerns that we must protect in order to continue to ensure access to the students, the eligible students in this country that go to postsecondary institutions, to eligible postsecondary institutions.

The problem is, as the program increases, and assuming a cap or other laws that Congress passes to diminish the Direct Loan Program, there is a major concern in our mind if Sallie Mae was a private organization as to whether we will be able to continue the access. The problem exists that Sallie Mae in the future, for example, assuming a private Sallie Mae, first their cash leverage will be reduced as compared to a private company, as compared to a GSE where they have certain leverage now in their cash situation. Secondly, they will need cash to provide both new enterprises or acquire enterprises.

And, if the GSL program continues to expand, and the Direct Loan Program does not, and this is why there is such a specific connection, what would happen is, and if Sallie Mae were not in the picture, we have a major concern as to whether the remaining secondary markets, which primarily work on tax-free bonds, could fill that gap, and that's our major concern.

The second major concern is, Sallie Mae is our lender of last resort. We have a contract with Sallie Mae on that basis. If that—if Sallie Mae were a private company and did not want to honor that commitment, and, again, if GSL is a major entity in the marketplace, we would have serious concern as to how we would cope with lender of last resort.

We already had a call on Sallie Mae today to provide lender of last resort service to some persons, so those are all significant concerns of our's.

I also want to make one other point, regarding the question posed as to what benefits Sallie Mae had as a result of the Federal GSA status. Sallie Mae, historically, has earned $3 billion since its inception. The initial investment to Sallie Mae was $750 million. Sallie Mae distributed $2.25 billion to its stockholders in dividends and other such benefits to their stockholders. So, this means that 70 percent, or thereabouts, of the total earnings that Sallie Mae has made has already been distributed back to their investors and, therefore, we feel in view of that, if Sallie Mae does private the government does warrant an exit fee of some sort.

Mr. GREEN. Thank you, Mr. Chairman, and if the members could also, in the question of Sallie Mae and Connie Lee, is if you could just briefly, and not under my time, but someone else's, talk about the markets you expect to go to, and where do you expect to in your privatization.

Thank you, Mr. Chairman. I'm squeezing out every second I can.

Chairman MCKEON. That's an interesting way to get another question in.

Mr. WILLIAMS. Mr. Chairman, would you yield?

Chairman MCKEON. Yes.

Mr. WILLIAMS. Mr. Chairman, I just want to note the presence of Congressman Edwards. Chet Edwards has a very important and vital Sallie Mae servicing center in his district, and although not a Member of either committee I appreciate, as does Congressman Edwards, your courtesy in allowing him, because of his great interest and the interest of his constituents, to join us here on the panel.

Thank you.

Chairman MCKEON. Glad to have him here. I know we are both supposed to be in another committee meeting at the same time. Appreciate your attendance.

Mr. Kanjorski, usually we try to go by who gets here first, but we understand you need to leave for a meeting, so we'll turn the time over to you right now.

Mr. KANJORSKI. I would appreciate that. I thought, perhaps, because we had a hearing yesterday on corrections, and the Chair didn't recognize everyone, I thought we had a policy now in the new administration of selective recognition, so I appreciate knowing that isn't a precedent that's going to be followed.

Thank you very much, Mr. Chairman.

Mr. Gunderson made a very good point, as to what would facilitate the continuation of this secondary market, and, as I understand it, anything we do in the Congress is not disturbing the 98 percent guarantee of student loans provided by the United States government. So, that product certainly lends itself to either a private market or a GSE-sponsored secondary market. That's not the issue. There will always be a market out there for government guaranteed securities, is that correct?

Mr. KORNFELD. That is correct.

Mr. KANJORSKI. Now, as I understand it, Sallie Mae was going along very well until we changed the policy and, therefore, changed their potential market and had a very negative impact on their stock and the portion of the market they were servicing. Is that correct?

Mr. KORNFELD. That is correct.

Mr. KANJORSKI. So, something that man has made man can take away or correct, and there's no unreasonable principle in government or nature that that occur, is that correct?

Mr. KORNFELD. That is correct.

Mr. KANJORSKI. Basically, as I understand the purpose, the argument is that to take Sallie Mae private there has to be an accommodation between the government and their stockholders to get the coordinated effort and approval of both sides, which are necessary to the agreement. That process, that negotiation, as I understand it from both Treasury and from Education, is a satisfactory, ongoing process.

The only thing that we really have to consider in Congress is first, is there any loss of taxpayers' money? I understand since an exit fee will be paid that will not occur. Second, that although the Direct Loan Program is ongoing, none of us have faith that it will be a total program, so we want to make sure that portion that remains has serviceability out there. But I understand there are many more competitors, besides Sallie Mae, that have been competing right along for that market, and there's no reason to assume they won't continue that competition. So, that is an area that probably we should be aware of, but is certainly not worrisome to the administration, is that correct?

Mr. KORNFELD. That is correct, Congressman. The point is that, as I stated before, privatization as a concept is a very good idea, and we, the administration, certainly support it.

As you get into the details, there are concerns, and we have to make sure that the bill which Treasury, and ourselves, and the administration are working on, make sure that as whatever happens, whatever Congress decides as to the future of the Direct Loan Program, that we still maintain access, because, as I mentioned earlier, 70 percent of all the loans in this country are sold and secondary markets purchase them. Half of them are Sallie Mae, and we must make sure that gap is closed.

Mr. KANJORSKI. Right. If there was a failure, nothing would prevent us from going back to a GSE, constructing another one, is that correct?

Mr. KORNFELD. Certainly, if Congress chose that.

Mr. KANJORSKI. I mean, there would be a time frame involved, but it's a manmade solution to a manmade problem, if you will.

Mr. KORNFELD. That is correct.

Mr. KANJORSKI. Okay.

What I'm most interested in, and I think Mr. Green asked somebody to ask the question, so I'm going to, I was interested last year in establishing a secondary market for small business loans. And, I see the expertise of Sallie Mae of lending itself to that capacity.

Mr. Hough, will you agree that part of your product could be small business loan packaging, economic development packaging, community development packaging, a whole new array as we run into the limited resources of Federal grants. There's a process out there by which we could privatize, if you will, infrastructure improvements by using the private secondary market, if under an organized effort, and the product were well sold and well represented by a company such as Sallie Mae, is that correct?

Mr. HOUGH. Yes. I don't want to give a hurried answer, however, because that is a complex area of credit. What I would emphasize at the outset is that all of our business, in our 22 years, as been conducted with partners from the financial institutions of this country. And, certainly, any secondary market in those kinds of loans would, at a minimum, have to be structured so as to invite their participation, and our role as a packager, and market maker, or a processor is certainly one that bears our careful consideration.

In the end, the structure has to enjoy the credit worthiness in order to attract funding support from the private investors.

Mr. KANJORSKI. Right. I understand that as a result of the national policy adopted by the administration two years ago, we basically took a great deal of your market away. And, at this point, Sallie Mae is bleeding. If we fail to take activity and allow you to expand the products that you are capable of, selling and have a force to sell, we run the problem of by inaction or failure to recognize how we affected your market, ultimately cause a loss to a very important structure within our society that now is capable of going into the competitive free market, is that correct?

Mr. HOUGH. That's exactly correct. While the devil is in the details, it's also the details that can bring this whole proposal to a crashing halt.

Our shareholders are fully able to understand the financial consequences of these so-called details. We have struggled over the last two years, trapped as we have been, without a future and without a means of growth, to demonstrate to our shareholders there's long-term value.

I would make one observation relative to the notion that one can restart a government-sponsored enterprise, having decided in 1995 to wind one down. Critical to the restart of any public/private partnership is a clear, and honest longstanding record that the bargain struck is a bargain that will be met in the long term.

If something is done to us on the way out, our shareholders won't approve it, and the signal that will send to future public/private partnerships, and future efforts to privatize, which in the broader sense is a bipartisan notion, this, the first such effort will be watched very closely. And, if the bargain struck is not fair, it will

slow down dramatically efforts in the future, which seek other privatized solutions.

Mr. KANJORSKI. Mr. Chairman, I'd just like to add, I know my time has run out, that we all in public life and in government talk about using the private sector and the free market system, and here we have an opportunity. The only caution I give is that, it's so typical, what we talk about and what we do are very often on different time tracks, and I would urge the administration, and Sallie Mae, and Connie Lee, to work very closely with the Congress, and I urge my colleagues on this joint committee, to recognize that time is of the essence in the decisionmaking process in the private sector, and that we do not have the luxury of putting off to tomorrow what can be done today.

So, I would urge everybody to move forward on this. I know there's a time constraint, and the result will be a dead body at the end of the line, as a result of time, if we don't take action.

So, thank you, Mr. Chairman.

Chairman MCKEON. Thank you. I appreciate those comments, and we do have the assurance of Ms. Bradbury and Mr. Kornfeld that they will help us on a very expeditious manner, because we are moving quickly on this, and we'll have that information to you, and would look to a quick response and appreciate it.

Ms. Woolsey.

Ms. WOOLSEY. Thank you, Mr. Chairman, and thank you to the panelists. This has been a very informative group of witnesses. I really appreciate it.

The concept of privatization of these GSEs, such as Sallie Mae and Connie Lee, is very interesting, and I think it's well worth discussing today. We are having a great discussion, and I'm looking forward to the legislation that will be introduced, and having this opportunity to hear the questions and the answers has made what this legislation should be a lot clearer to me.

A lot of my concerns have been raised, but I have two questions. One for Mr. Hough, Sallie Mae has some really good special programs, which benefit student borrowers, and I want to make sure that these programs would not be discontinued if you privatize.

Mr. HOUGH. I thank the Congresswoman for raising that point.

We have, in the last year and a half, as a way of strengthening the Guaranteed Student Loan Program's attractiveness in delivering a modest amount of encouragement to the borrowers who, in this day and age, must rely on credit to support their education, benefits in the event that they make their first 24 payments on time and their first 48 payments on time, that are very attractive and substantially reduce the interest rate that the borrowers would then pay.

I'd add that these are benefits that are attached to the Guaranteed Student Loan Program, which if copied by the Direct Loan Program would actually require a change in Federal statute and the same budget neutrality scoring problem that we have presenting us as we try to privatize.

Let me assure you that it is our every expectation that those borrower benefits will be continued. We are also very hopeful that Chairman Goodling's proposal with respect to amending current law would also enable us to provide, as has Senator Kassebaum

agreed, provide other benefits to students, including income contingent repayment, so that all students in this country can have the benefit of an income contingent repayment opportunity should they so choose.

The banking industry stands ready to embrace President Clinton's idea that if necessary income contingent repayment would be available. As a fully private company, we stand prepared to further the benefits, not merely just continue them.

Ms. WOOLSEY. Thank you. I understand that as a GSE Sallie Mae is not required to pay local taxes. What would happen in the event that you were privatized?

Mr. HOUGH. We would be taxpayers in Kansas, Texas, Florida, Massachusetts, Illinois, North Dakota, Pennsylvania, California and the District of Columbia.

Ms. WOOLSEY. Then, the other question I have is to Mr. Kornfeld. It sounds like Sallie Mae is willing to make a commitment to continue in its current role after privatization, so do you believe there would be enough diversity so that we would have the backing you are looking for for student loans?

Mr. KORNFELD. The concern we had is that, in order for Sallie Mae to—for us to be comfortable that these—that Sallie Mae will continue in support of the GSL program, as you describe, we feel that this has to be part of legislation and with specific commitments, because as I mentioned before, a problem that Sallie Mae as a private company will have is that there will be other demands on their cash in order to acquire or build new enterprises. And, that pressure might cause them to diminish their support of GSL.

So, our concern, and, again, it gets back to the details, our concern in the legislation we are working on, we want to make sure that the legislation includes specific commitments in law from Sallie Mae that they will support the GSL program.

Ms. WOOLSEY. Thank you.

Thank you, Mr. Chairman.

Chairman MCKEON. Thank you.

Mr. Gunderson.

Mr. GUNDERSON. Thank you very much, Mr. Chairman. I have a couple questions.

The first question I can't help but ask. Mr. Hough, are you considering any expansion of service centers around the country?

Mr. HOUGH. I omitted in my list from jurisdictions where we will be paying taxes Washington State. We have begun to develop a servicing operation in Spokane, and I would hasten to add that in your State, Wisconsin, you have probably one of the two or three top servicing organizations in Madison, the Great Lakes Higher Education Corporation. They are such formidable competition that at this juncture there's no midwestern servicing operation in our plans.

Mr. GUNDERSON. We need to talk about that.

I have a more serious question, though, will someone tell me, what is the administration position?

Ms. BRADBURY. I don't think the Department of Treasury and the Department of Education are disagreeing, I think we each have expertise in different areas, and so we've tended to highlight those different areas in our testimony today.

We've been working very closely, Leo and myself, and a whole cast of people at both departments, and people throughout OMB and NEC, to try to develop legislation that provides for an orderly transition, both to protect the taxpayers, in terms of its impact or potential impact on the Treasury's finances if the GSE were to develop financial difficulties, we want to prevent that during the transition, as well as to prevent disruptions in the vital student loan programs that we know are so important.

And, in fact, we would—the legislation that we've been discussing, and discussing in general terms with Sallie Mae, would provide for a transition period of years in order to have them be able to wind down their GSE operations in a very careful and deliberate manner, and that's vitally important to all of us.

Mr. KORNFELD. And, as stated before, we do support privatization. What we are working on, the legislation that we're working on with Treasury and others, is to make sure that, first, to go back one step, it's a complex issue, as you point out and stated so many times already, the devil is always in its details. In the legislation that we are proposing, that we are working on, that we will be proposing, that we are working on for privatization, we want to make sure we address the continuing need, the exit fee and the offset fee, and we want to make sure that—and what we are struggling with is to make sure that we set this up in such a way that supports the concept of privatization, but it also supports the taxpayers.

Mr. GUNDERSON. But, Mr. Kornfeld, if you guys get your way, and we get 100 percent direct lending, based on the experience with the value of Sallie Mae stock since you began this initiative, you are not only not going to get an exit fee, you are going to have a defaulted company on your hands. I mean, it bewilders me that on one hand you are supporting legislation that, frankly, puts them out of business, and secondly you are going to ask them to pay you for the privilege of surviving after you've put them out of business in the first place.

Mr. KORNFELD. Well, of course, you are assuming 100 percent, and if 100 percent occurs, clearly, there's no need for a GSE, and all the conversations we've had to point, all these points that we describe go away very quick like.

Mr. GUNDERSON. But, you are suggesting that if they want to survive, after you've decided through legislation that there's not a role for them directly, that they've got to pay you for the privilege of surviving.

Mr. KORNFELD. The point remains that if—in the—this is a difficult—obviously, a difficult thing to put together, but we are not asking them to pay for us to survive. We are being very careful——

Mr. GUNDERSON. Does the Treasury support an exit fee?

Ms. BRADBURY. Yes, the legislation that we've been working on has two aspects. One is the offset fee that you mentioned.

Mr. GUNDERSON. I understand we've got to deal with that.

Ms. BRADBURY. Which is very important, you know, to maintain deficit reduction, and the second is the idea of, essentially, a contingent kind of a thing, which we've described as possibly warrants or some other way that the U.S. government could benefit in any future success that Sallie Mae has. And, those are the two——

Mr. GUNDERSON. Well, you know, we just passed some takings legislation here in the House earlier. Are you saying that the stockholders then can sue the government for taking the value of their stock?

Ms. BRADBURY. I'm sorry, Mr. Gunderson, I'm not a lawyer, and my husband is and he's warned me over the years, he says, never comment on things you don't understand, so I will defer that to other people. I apologize.

Chairman MCKEON. You don't have to apologize here for not being a lawyer.

Mr. GUNDERSON. No, we appreciate it.

Thank you, Mr. Chairman.

Mr. KORNFELD. No, just to pick up the point on an exit fee——

Chairman MCKEON. Mr. Kornfeld, we need to move on on this one.

Mr. KORNFELD. [continuing] okay.

Mr. MCKEON. Mr. Roemer.

Mr. ROEMER. Thank you, Mr. Chairman. I will be brief in my questions, because I think we've covered a lot of ground this morning. But, I just want to reiterate and reaffirm a few points.

One is the assurance that there will be no diminishing or curtailing of construction projects at colleges or student loans, and that today's panacea for privatization does not become tomorrow's Pandora's Box of potential problems. We've heard a number of you say that, Mr. Kornfeld and Mr. Hough, can you guarantee that this privatization issue will not have a negative ancillary effect on the amount of student loans or the degree and speed of construction on campuses?

Mr. HOUGH. I would reaffirm my commitment in that regard, noting as well, as all of us would understand, that that assumes a certain stability in this program, and a certain stability in the market where we today make actively facility financing loans and provide letters of credit to support those efforts.

It is our expectation to continue to do that and serve those markets, because that's the business this company knows.

Mr. ROEMER. Mr. Kornfeld?

Mr. KORNFELD. As I stated before, as long as it is clear that Sallie Mae will support the GSL, regardless of its size, and make sure that there is not a gap, so that access is diminished for those eligible persons and those eligible institutions, we would support—obviously, support privatization, and it's that kind of thing that we want to make sure is in the legislation, to make sure that commitment is fulfilled.

Mr. ROEMER. From what you both just said, and from what has been asked and then answered in this hearing thus far, would you then advocate separate pieces of legislation in treating these separate privatization issues for Connie Lee and Sallie Mae?

Mr. HOUGH. That would be my recommendation. I'm not the expert on the legislative process, but they are sufficiently discreet.

Now, I mean, Mr. Sockwell can speak for himself, I would just echo the comments of Congressman Kanjorski, and that is, time is of the essence. There are some very important timing issues that this corporation is facing. It's very important to send a positive signal as soon as possible that this is the intent.

Mr. KORNFELD. We are proposing two separate pieces of legislation, Congressman, one on Connie Lee and one on Sallie Mae.

Mr. ROEMER. Are there different precedents and models that you are using and have carefully studied as a paradigm that will make this transition as efficacious as possible?

Mr. KORNFELD. Yes. As you know, the government has had no experience in converting a GSA to a private company, so this is also——

Mr. ROEMER. So, there's nothing that you can use as a model, this is all brand new.

Mr. KORNFELD. [continuing] it's all brand new, and they are two, as mentioned so many times already, they are two different kinds of activities.

Ms. BRADBURY. And, because of the two different kinds of activities that the corporations are both involved in, our legislation is very different. In Connie Lee, it's primarily one of, we are selling the government stock and severing the ties, and we are not going to be able to do that in one day, it's probably going to take us a matter of months to do that, and during that short transition period we would want to make sure that things were protected.

The Sallie Mae, and we've had extensive discussions with Sallie Mae, we haven't just been talking to ourselves, in those discussions they believe they need a transition period of years to wind down their business and gradually use capital to build up a new business in a way that's productive, and we think that sort of gradual transition period is particularly appropriate, given the many changes in the Student Loan Program, both the Guaranteed and the Direct Loan Program, that have occurred in the past several years.

Mr. ROEMER. Finally, Mr. Hough, all the witnesses seem to agree that this is going to be a complicated issue, each one seems to support privatization with two caveats. One, that the markets don't change, and secondly, that this be a fair bargain, as a signal to the rest of the market. Is there anything else that we need to be aware of and concerned about in addition to those two things?

Mr. HOUGH. Thank you for reiterating, the third is merely what Congressman Kanjorski had noted, which is speed. Thank you.

Mr. ROEMER. Thank you.

Mr. McIntosh.

Chairman MCINTOSH. Thank you, Mr. Chairman, and first let me commend you for chairing this joint hearing between our subcommittees. I have the pleasure of sitting on both of them, and think that this is a very important issue, one that I strongly support as an effort to move forward. I have a statement that I will put into the record.

I have a question, though, from the discourse back and forth for Mr. Kornfeld on the need for some of the protection for continuing support of the GSL program. You indicated you thought that it would be preferable to put that protection into law. I was wondering why it would not be satisfactory to put that into a contract with Sallie Mae, secured by the $50 billion in assets that they have, so that it, in fact, becomes a business transaction between the government and the new corporation.

Mr. KORNFELD. And, that might be another way to do it. Our concern, clearly, is that we must have a specific commitment, that

if Sallie Mae is a private company, regardless of the future volume of GSL, that there is not a gap out there that cannot be met.

As I mentioned earlier, Congressman McIntosh, the problem is that the remaining secondary market companies in this country are primarily financing their purchase of loans from the lenders in this country through secondary, through tax-free bonds. And, as you know, tax-free bonds are limited by State rules, that you can't—every entity cannot issue unlimited tax-free bonds.

The other concern we have, tax-free bonds cost the taxpayers money. The $17 billion that have been issued by the secondary markets in this country have cost the taxpayers a billion dollars already. And, what our concern is, and that's what we are working on with Treasury and others, our concern is to make sure that we figure out how to still provide access and still not increase the cost of this program to the taxpayers.

Chairman MCINTOSH. So, if you switch to some of the competitors of Sallie Mae, there would be an additional cost to the taxpayers, because of the way they finance them.

Mr. KORNFELD. Let me take a scenario. Let's assume, for example, and as you know, one of your concerns, one of the things that Congress is considering is to eliminate the Direct Loan Program, and let's assume that occurs, or something between that and the capping that's being considered. That suddenly means that there is a significant guaranteed loan volume out there, and if Sallie Mae, if it was private, this leaves us with major concerns that have to be looked at, because what we need Sallie Mae for is, first, they have to make sure that they still will utilize their cash that they have, not only for their new entities but to keep supporting the Guaranteed Loan Program, and that's going to be a very difficult decision for them to make year by year, because as they need additional cash for their acquisitions or their new businesses, as the fact that they no longer would have the cash leverage that they have as a GSE, it almost doubles the amount of cash they would have to put up for all these entities, there will be pressures on Sallie Mae to go into other things and not support the Guaranteed Student Loan, because that's where their future will be in their new entities.

And, these kind of things, obviously, concern us and we must have that kind of protection, and that's what we are working on with Treasury.

Chairman MCINTOSH. I understand that in the contract, and I would think a contract could provide some of that, but I always thought that Sallie Mae's would be on the same basis as their competitors.

Mr. HOUGH. If I may, Congressman McIntosh, the concern about leverage, as it's been presented here, is, with all due respect, quite naive.

As a practical matter, the capital markets in our U.S. economy today, with a lot of bank support and innovation from Wall Street as well, have shifted to securitization as a preferred approach in a great many instances where three, four or five years ago it might have been just a straight debt financing arrangement.

Sallie Mae will be an active participant, as a securitizer of student loans, in many instances the key to securitization is the back

room. We have as good a servicing capability as anybody in this business, and could look forward to securitizing billions of dollars each year, and in that way access the capital market with leverage which is today better, which would be better than the leverage that we today enjoy as a GSE.

So, there's really no merit in this notion that from a capital basis we would be constrained as it has been suggested.

As a footnote to the contract alternative to writing into Federal law, we would be, indeed, as you would expect I think, most eager to put any of these technical details in place in negotiating, as you suggest, by contract rather than legislative language.

Chairman MCINTOSH. While the Chairman is distracted, let me ask one follow-up question. Could I have two more minutes?

Mr. MCKEON. Can I ask you to do it later?

Chairman MCINTOSH. Yes.

Mr. MCKEON. Mr. Reed.

Mr. REED. Thank you, Mr. Chairman.

Just an observation first. I think with the passage of the Direct Loan Program, there is a compelling logic to allow an efficient and timely privatization of Sallie Mae. With the discussions about caps and retreats on direct loans, it's a bit confused but I still think you have to operate with the basic logic that as their role diminishes they have to look elsewhere for business opportunities and continue to deploy their assets in an efficient way.

But, let's assume for the moment that we will move down this privatization trail, Mr. Hough, you are prepared to, essentially, sever all ties with government support, in terms of any tax exemptions you might have now, or anything else other than what a normal State business corporation would have, is that correct?

Mr. HOUGH. That's correct, sir.

Mr. REED. Let me ask another question, and this goes to a sort of recent experience in my home State, where we had an entity that was a private institution but performing a public role, and got into lots of trouble and the State had to step in and bail it out. And the concern I have is that, going forward, even though you will legally not be a government entity, the public perception might be that you still are. So, I would ask you to think and ask Treasury and Education to think of what we would have to do to make it clear that once you've left the GSE paternity, that not only you know, and Treasury knows, that the general public also knows that you, in fact, are completely private with no contingent liabilities of the Federal Government. Is that something you'd be amenable to?

Mr. HOUGH. We would be very pleased to advertise and otherwise support that conclusion, and would also be pleased for the U.S. Treasury to do that as well.

For a number of years, when the question of your debt being implicitly guaranteed by the government was raised, we always encouraged the government to more explicitly announce that our debt wasn't implicitly guaranteed. So, whatever we can do to clarify to both our debt investors and our shareholders that we are a State-chartered company and have no obligation to the U.S. taxpayer beyond that I would applaud.

Mr. REED. Let me ask another question, too, and this goes to where you are going after you leave. There is a concern, I think it's

a legitimate concern, that there are some activities that, if not substantively, at least symbolically, we'd feel a little sheepish about. For example, if you suddenly ended up being an international trader of substances and things that we don't like. Would you be amenable to some parameters about what you could do after you leave? And, I know that as a business person you have to be sensitive to not laying out your whole strategy, because then you price yourselves out of your respective markets, but I think it's reasonable, at least at this juncture, to consider some broad parameters of what you might do afterwards, and I'd like your thoughts.

Mr. HOUGH. I mentioned before that at the end of the day, Congressman Reed, I've got to sell this to shareholders, and any encumbrance on my future, of course, has to be explained.

I am prepared to explain the types of considerations that might come up as a consequence of negotiations along the lines that you are mentioning.

I would urge, or I should note at this point that I would be seeking to sunset those encumbrances. I would be seeking to qualify them, so that at the end of the day they are explainable, because at the end of the day our shareholders are going to vote up or down. And up, we are on our way, down, we are back to the drawing boards and confronting some truly difficult alternatives to try and make this thing work.

My shareholders today are hearing alternatives. There is dissident shareholder activity. This harkens back to the decade of the 1980s. You have Chrysler in dispute, you have efforts against Chase, and I have that kind of problem.

The Sallie Mae solution to dissidents we are proposing is not an orderly transition.

Mr. REED. I've got one final point which I'd like to get in before my time expires, and I think it is an important point going forward, considering this whole privatization. Often, we are accused of sort of fighting the last war and not looking at the current war. The last war might be the Direct Lending Program, what it's done to your business enterprise.

The oncoming struggle is for a change in the student loan program. We are talking about eliminating the in-school interest subsidy and budget constraints. I would hope that both Sallie Mae, the Treasury Department, and the Department of Education are looking very carefully at what the new world of student loans might look like if some of these proposals are in place, making a judgment about whether, from your business perspective, it makes sense to be private or to stay public, and from the government's perspective, has this changed fundamentally the student loan marketing that we do or do not need Sallie Mae, or we need to do some other things.

So, I would hope that as we go forward the future is considered as well as the recent past.

Thank you very much.

Mr. HOUGH. I would expect our corporation to be even more able to support the legislation that would, perhaps, in the next decade, if not before that, redefine the Student Loan Program in some other respect. It's our business. We have two decades of experience.

We are experts, and we'd be more than welcome to be supportive of new directions in that respect, sir.

Chairman MCKEON. Thank you, and I want to thank the panel members for being here and for your participation, Members of the committee for their questions and their participation.

We will now go to the second panel, and I will turn the Chair over to Chairman McIntosh, who Chairs the other subcommittee that we're sharing this hearing with.

Thank you very much.

Chairman MCINTOSH. [presiding] Thank you both for joining us. Our next panel are two experts outside of the government, Mr. Fred Khedouri, who is a former OMB official in the Reagan Administration, and an expert in privatization. He is now the Senior Managing Director at Bear Stearns & Company. Mr. Robert Torray is the Fund Manager for various investment funds and has had a lot of expertise on some of the views of the stockholders in Sallie Mae and is the President of the Robert Torray & Company.

If I could ask both of you to please rise and take an oath with me. On the Government Reform Committee, Chairman Clinger has requested that we swear in all witnesses.

Let the Clerk record that the witnesses answered in the affirmative.

Mr. Khedouri, if you could lead off with your testimony.

STATEMENT OF FRED KHEDOURI, SENIOR MANAGING DIRECTOR, BEAR, STEARNS & COMPANY, INC.

Mr. KHEDOURI. Thank you, Mr. Chairman.

Mr. Chairman, Members of the subcommittee, I am Fred Khedouri. I'm the Senior Managing Director of Bear, Stearns. I've been there for eight years now. My principal activities are investment banking for Federal agencies like the RTC and FDIC, the government-sponsored enterprises, the World Bank and similar entities, as well as any transaction involving a guarantee, such as the financings we've done for the government to Israel.

We are a very large participant in the market for mortgage and asset-backed securities. We've done over $250 billion in the last five years. I think that our volume has been averaging about $50 billion a week in trading of these types of securities, so I think we have a certain familiarity with the markets into which the Guaranteed Student Loans go.

Today, I'm going to focus on whether Congress should consider ending the status of Sallie Mae as a government-sponsored enterprise. I'd also like to identify a couple of issues that should be given particularly careful review as you consider legislation affecting its status and that of Connie Lee.

Frankly, as with many government policies, if you do nothing to change the status of Sallie Mae, you would, itself, be making a significant policy decision. The financial markets have undergone a great deal of drama in the past 20 years since Sallie Mae became active. We've had high inflation, we've had low inflation, we've had strong dollars, today we have a very weak dollar. We've had high interest rates and steep yield curves. We've had low interest rates. We've had inverted yield curves. We've seen periods of time in

which financial institutions had very large profits, we've also seen hundreds of financial institutions become insolvent and fail.

Most significantly, we've seen tremendous change in the way in which the capital markets themselves operate. Partly in response to these stresses, today there are many techniques available to manage risks that were not available 20 years ago when Sallie Mae was first created. These markets do not resemble the markets into which Sallie Mae first was launched, and, as a consequence, the original justification that led to the creation of Sallie Mae as a GSE may no longer be valid.

The basic logic by which GSEs operate is to cause something to happen in the marketplace that would not happen in the absence of the GSE, typically, because of risks that the capital markets cannot price efficiently, and often exacerbated by legal or regulatory impediments.

The creation of a GSE, thus, provides access to capital for the specified purpose, by shifting the management of these risks from investors indirectly and eventually to the Federal Government.

When the GSEs are well run and carefully supervised, this process causes the market to operate relatively efficiently, more than it would in its absence, and creates benefits that offset the risks that the taxpayers have implicitly undertaken.

If nothing ever changed, that would be the end of it. Congress would set up GSEs that would monitor their activities. It would watch the money go where it wants it to go, into the desired activities, whether it's Housing, Education or Agriculture, to name the principal sectors that benefit from GSEs.

But, Sallie Mae is in an excellent example of a Federal program, and certainly creating and maintaining a GSE is, in fact, a Federal program, even though it may not cause any budget outlays, and it's necessary to ask a simple question. Are the reasons and the policy objectives that led to Sallie Mae being established still going to be met if it is no longer a government-sponsored enterprise? I believe firmly that the answer to this question is yes. Sallie Mae's purpose was to encourage lenders to participate in the Guaranteed Student Loan Program by assuring them that they would have a source of funding and liquidity for the loans that they made.

Back then, there were severe limitations on interstate banking. There were regional economic variations that would cause some financial institutions to stay out of student loans in favor of other types of lending, because money did not flow freely across the country, and when you have net savings areas, you would have surpluses of available capital for lending, and the capital short areas, the institutions would not be able to meet the local requirements.

Sallie Mae was a great solution at the time to this problem. It raised money nationally, originally by borrowing through the Federal Financing Bank, and later as a participant in the capital markets using its agency status. They are extremely astute borrowers. They use every technique as it becomes available, and they achieve extremely low costs as a result, but that is in no small measure dependent on their agency status.

If Sallie Mae stopped being a GSE tomorrow, would we see lenders not willing or able to participate in the Student Loan Program, because of the limited liquidity or regional shortages that led to

Sallie Mae's creation? The answer to that is clearly no. Today we have alternatives to Sallie Mae that didn't exist. We have the State chartered public and non-profit guarantee agencies that operate secondary markets in every part of the country, and they do tap into the national capital marketplace, typically, through tax-exempt offerings.

Even more significant for the long term, because of the limitations on tax-exempt financing, is the availability of the private securitization market. When Sallie Mae got started, it really wasn't possible to efficiently structure in trade securities backed by student loans. There were just too many numbers involved, too many uncertainties. And, without, really, the computer technology that we have today, you just couldn't have done it.

However, and in addition, of course, there was the problem with the Investment Company Act, which would have made it very difficult to securitize non-mortgage assets.

The answer today, however, is the availability of securitization. Non-mortgage securitization, you know, has grown tremendously. Student loans alone are at an operating annual rate of more than $2.5 billion last year, so far this year there's been over a billion dollars. Mortgages, you know, leads to technology, and the annual rate is over $200 billion.

We can do this efficiently now, we couldn't do it in 1972. We'll raise capital around the world and that can flow into student loans, and we can price the risks and raise funds for the lenders to keep them in the program.

There are a couple points, as I mentioned, to keep in mind as you would move forward. One is that the shareholders of Sallie Mae did, in fact, provide a great service by making capital available and making this whole thing run and funding the investments that built the company up. There is a bargain with them. It's a fairly explicit bargain, I think, and it needs to be preserved. It obviously should have the opportunity to approve any changes in the status of the company that are made.

A second consideration, which goes beyond Sallie Mae itself, is to preserve the status of its existing agency debt. I think that seems to be a subject on which there's consensus, and finally, Sallie Mae, when it goes forth as a wholly private company, should not be especially encumbered. There's no particular purpose by that if the idea is that it becomes private, it should be private, and not have an extraordinary regulation upon it.

I've run over a little bit. Thank you, Mr. Chairman. If there are any questions I'd be happy to answer them.

Chairman MCINTOSH. Thank you very much for your testimony. I appreciate that. Why don't we take Mr. Torray's testimony, and then see if there are questions for either of you from members of the committee.

[The prepared statement of Mr. Khedouri follows:]

Statement of Frederick N. Khedouri
Senior Managing Director
Bear, Stearns & Co. Inc.

Subcommittee on Postsecondary Education,
Training and Life-Long Learning

Subcommittee on National Economic Growth,
Natural Resources and Regulatory Affairs

Committee on Economic and Educational Opportunities
U.S. House of Representatives

May 3, 1995

Restructuring of the Student Loan Marketing Association

Mr. Chairman, Members of the Subcommittees. My name is Frederick N. Khedouri. I am a Senior Managing Director of Bear, Stearns & Co., having joined the firm eight years ago. I am responsible for investment banking activities for Federal agencies, government-sponsored enterprises, and supranational entities such as the World Bank, as well as transactions for private firms and foreign governments that rely upon U.S. guarantees. My principal expertise is in structured fixed income transactions such as collateralized mortgage obligations and other types of mortgage and asset-backed securities.

Bear Stearns is a worldwide investment banking firm with 7,000 employees, ranking fifth among U.S. firms with over $5.7 billion in capital. We are regularly among the three largest underwriters and market-makers in mortgage and asset-backed securities, having lead managed over $250 billion in new issues over the past five years. Our weekly fixed income trading volume averaged over $50 billion last year, displaying the breadth of our involvement in the capital markets.

My testimony today will focus on whether Congress should give consideration to eliminating the status of the Student Loan Marketing Association ("Sallie Mae") as a government-sponsored enterprise. I will also identify several issues that should be given careful review when drafting legislation affecting the status of Sallie Mae.

As with many government policies and regulations, lack of action on the status of Sallie Mae -- simple inertia -- would itself be a significant policy decision. The financial markets have been a place of drama since Congress chartered Sallie Mae over twenty years ago. Over this period, we have experienced very rapid inflation and very low inflation; a strong dollar and a very weak dollar; high interest rates and relatively low interest rates; record profits for banks and thrift institutions and the failure of hundreds of banks and thrifts; and we have seen the capital markets evolve a wide array of techniques to manage the risks inherent in these large shifts. As a result, the financial markets today do not resemble the markets as they existed at the time Sallie Mae began operation. More to the point, the nature of the changes in the marketplace may well have removed the primary justification for Sallie Mae's status as a government-sponsored enterprise.

The essential logic of all the government sponsored enterprises is to cause something to happen in the marketplace that would not happen otherwise because of risks that are difficult for the market to price efficiently, usually exacerbated by legal and regulatory impediments. Creation of a government sponsored enterprise thus assures access to capital for a specified purpose by shifting the management of risk

from investors to the Federal government. When the government-sponsored enterprises are well run and carefully supervised, this process can bring about efficiency gains in the marketplace that offset the risks that are shared by the taxpayers.

If nothing ever changed in the world, that could be the end of the story. Congress creates a government sponsored enterprise, sets up an appropriate regulatory framework to monitor its activities, and sits back to watch the money flow smoothly into the desired activity, whether it be it housing, education, or agriculture, to name the primary sectors benefitting from government-sponsored enterprises.

Sallie Mae is an excellent example of a Federal program -- and creating and maintaining a government sponsored enterprise is most definitely a Federal program even though no budget outlays may ever result -- for which the time has come to ask a simple question: Will the policy objectives for which Sallie Mae was established still be met if it is no longer a government sponsored enterprise?

The answer to this first question is a resounding "yes." Sallie Mae's original purpose was to encourage lenders to make guaranteed student loans by providing them with an assured source of funding and liquidity. The limitations on interstate banking and regional economic variations had caused some financial institutions to shun student loans in favor of other types of lending by preventing money from flowing freely from "net savings" areas of the country to "net lending" areas. Sallie Mae provided an excellent solution to this problem. It raised money nationally, at first by borrowing

from the U.S. Treasury (through the Federal Financing Bank) and later by borrowing in the capital markets using its "agency" status to obtain low-cost funding.

If Sallie Mae stopped being a government-sponsored enterprise tomorrow, would we again see lenders unwilling or unable to participate in the guaranteed student loan programs because of limited liquidity or regional shortages of funding sources? Absolutely not. Today we have two extremely important alternatives to Sallie Mae that did not exist at the time of its creation. Almost fifty separate state chartered public and nonprofit guaranty agencies now operate secondary market programs in every part of the country and can tap into the national capital marketplace through tax-exempt debt offerings.

A second, even more flexible alternative is the availability of private securitization transactions to create liquidity for student loans. When Sallie Mae got started, it would not have been technically possible to efficiently structure and trade a security backed by student loans. Technology has now made it possible to track the cashflows from tens of thousands of loans, project prepayment and delinquency rates, and calculate yields at relatively low cost. In addition, the Securities and Exchange Commission revised its interpretation of the Investment Company Act of 1940 in late 1992 to exclude trusts holding consumer loans from regulatory requirements that had seriously impeded securitization. The result has been an explosion of activity in the market place, including many transactions using guaranteed student loans as collateral.

The private capital markets now have the ability to do what could not be done efficiently in 1972. We can create investment vehicles using pools of guaranteed student loans and sell the resulting securities to investors around the world at prices that very efficiently capture the full value of the loans. In short, we can price the risks and raise funds for lenders participating in the guaranteed student loan program without the need for a government-sponsored enterprise to intermediate.

It is important to note that Sallie Mae itself has made enormous contributions that helped create this more efficient market. It set up information systems, standardized origination practices and servicing, and put in place many other mechanisms that furthered the evolution of the marketplace to its current state of sophistication. In short, Sallie Mae helped to create a marketplace in which its unique status as a government-sponsored enterprise was no longer a barrier that keeps potential competitors from eroding its margins.

I am confident that the public purposes for which Sallie Mae was chartered can be fully discharged through non-Federal and private sector mechanisms already in place. This leaves us with a very important question, however. What do we do with Sallie Mae itself? Private shareholders supplied the equity capital to build Sallie Mae, absorbing considerable risks alongside the taxpayers, whose risk exposure was never more than implied (although the failure of the Farm Credit System irrevocably proved that the implied Federal backing of a government sponsored enterprise could most definitely turn into a cash commitment). The trading in Sallie Mae stock during and

after the debate on establishing the direct Federal student loan program illustrates the near for clear and careful statements of policy.

Fortunately, I believe that in this instance the goal of demonstrating that the Federal government can successfully declare a job well done and retire from the field and the basic requirement of fairness to Sallie Mae's equity investors are not in conflict. If the Federal link is severed on a prospective basis, the Sallie Mae shareholders will have a natural transition period in which the company will still enjoy earnings based on its prior efforts while developing new sources of revenue in areas of business that it is now precluded from entering. Indeed, failing to give shareholders the option of ending Sallie Mae's government-sponsored enterprise status would trap their equity in a business that is increasingly exposed to competition but that lacks the flexibility of wholly private companies to seek out new opportunities.

As I indicated at the outset, there are a few key points that must be borne in mind in crafting legislation to end Sallie Mae's status as a government sponsored enterprise:

- *Fairness to shareholders.* Any restructuring of Sallie Mae must preserve the bargain that the Federal government made with the company's equity investors by providing them the opportunity to approve or disapprove any proposed change in structure.

- *Stability for debt investors.* The debt issued by Sallie Mae prior to the effectiveness of a restructuring cannot be expressly or implicitly modified in any way. Investors in these securities purchased "agency debt," with all the attendant legal and credit features. In exchange for these "agency" attributes, investors accepted extremely low yields -- shorter maturity fixed rate agency debt often trades at yields that are only 0.08% to 0.10% higher than U.S. Treasury securities. Failure to maintain the full agency status of Sallie Mae's existing debt would send a tremendous shock wave through the capital markets that would raise the cost of borrowing for the other government sponsored enterprises and affect the corporate markets as well.

- *Sensible regulatory environment.* The restructured Sallie Mae should be not be subjected to regulatory requirements that go beyond those governing private market participants except to the limited extent necessary to protect Federal interests during the transition period in which Sallie Mae "agency" debt remains outstanding.

In closing, I would like to thank the Committee for the opportunity to present my views. I would be pleased to respond to any questions that the Members may wish to raise.

STATEMENT OF ROBERT TORRAY, PRESIDENT, ROBERT TORRAY & COMPANY

Mr. TORRAY. Thank you very much, Mr. Chairman, and Members of the subcommittee. I particularly want to thank those of you who have remained. I feel somewhat deflated at the departures, but anyway, my name is Bob Torray. I'm the President of Robert E. Torray Company in Bethesda, Maryland, the President of the Torray Fund, which is a public mutual fund, and the Chairman of the Birmingham Capital Management Company of Birmingham, Alabama, which is also an investment management company.

All these entities manage investments for pension funds, charities and individuals. We represent Fortune 500 companies, and I'll be brief in this, labor unions, policemen, State teachers pension fund, county government, one State, the American Association of Retired Persons, and the Catholic Archdiocese of Miami. All told, we control about $1.6 billion, and we own 1,484,400 shares of Sallie Mae, which I have acquired over the last several years.

Chairman McKeon and Chairman McIntosh expressed particular interest in a letter to me in my views on the likely effects of privatization on Sallie Mae and on Connie Lee. I'm going to confine my remarks to Sallie Mae, since that's the entity in which I am invested.

I'm going to begin by saying that we think the merits of privatizing are best viewed within the context of the risk to the shareholders of not doing so. On this issue, the market has already rendered a harsh judgment. The threat to Sallie Mae's existence posed by the reduction and possible replacement of the market, which the company was created to serve, has caused the shareholders to vote with their feet.

From its peak price several years ago, Sallie Mae stock, at the close of 1994, had declined a staggering $4,400,000,000, and I want to underscore three times here that that number is approximately 50 percent greater than the entire cumulative earnings of this enterprise in the 21 plus years of its existence. That number exceeds by two times the retained earnings of the enterprise, which are a measure of stored value, again, over that same period of time. So, it can be summarized that Sallie Mae shareholders have suffered an enormous, unforeseen and, I believe, undeserved loss.

Furthermore, if direct lending meets its targets, I can foresee very little chance that these losses will be recovered in a reasonable time. Consequently, our organization and the folks that we represent, many of whom have expressed an interest directly to me in this company because of their substantial investment, believe that privatization is the intelligent and fair solution to the company's problems.

Although the likely effects are difficult to gauge at this moment, the consequences of leaving the company straightjacketed in its GSE status strike me as both predictable and negative for the shareholders. The losses already inflicted testify to the financial market's judgment about this company's prospects in the current operating environment.

I wish to emphasize here that from our perspective the uncertainty created by not knowing how the restructured company will

be structured are considerably offset by the confidence that I have in the CEO, Larry Hough, and his management team.

Let me conclude by registering a very strong objection on behalf of all shareholders to the concept of an exit fee. It's my understanding that the proponents of this concept believe the government should be paid for its role in creating Sallie Mae, and the values which had been built up in the company over the last several decades.

It's our view that these values have been substantially eroded by the government's planned reduction in Sallie Mae's market and the imposition of the 30 basis point offset fee.

I particularly want to also reject the notion that some people seem to hold that Sallie Mae has been some sort of a bonanza for the stockholders and the management. In that connection, our calculations indicate that an investor that bought Sallie Mae at the close of 1983, shortly after its public issuance, has realized a compound annual return of 11¾ percent as of the close of 1994, December 31, 1994.

During that same 11-year period, the stock market, as measured by the S&P 500 Index compounded at 13.6 percent per year. So, in spite of the benefits that have been conferred on this company by the Federal Government, it's our view that shareholders could have done even better if they had just invested in the stock market in general, and in that context, I believe that any notion that the shareholders should be required to pay the Federal Government to be released from the present conditions is clearly unwarranted.

I thank you very much for your time.

Chairman MCINTOSH. Thank you, Mr. Torray.

[The prepared statement of Mr. Torray follows:]

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STATEMENT OF ROBERT E. TORRAY
PRESIDENT AND CHIEF EXECUTIVE OFFICER
ROBERT E. TORRAY & CO. INC.

Mr. Chairman and Members of the Subcommittees:

Good morning. It is a pleasure to be with you today to discuss Sallie Mae's future.

My name is Robert Torray. I am the President of Robert E. Torray, & Co., an investment management organization based in Bethesda, Maryland, President of the Torray Fund, a publicly traded common stock mutual fund, and Chairman of the Birmingham Capital Management Co., Birmingham, Alabama. These entities manage investments in the stock and bond markets on behalf of pension funds, charities and hundreds of individuals. Our clients include Fortune 500 companies, labor unions, policemen, The American Association of Retired Persons, and the Catholic Archdiocese of Miami, Florida. All told we oversee about $1.6 billion. Our investment in Sallie Mae, purchased over the last several years, totals 1,484,400 shares.

Chairman McKeon and Chairman McIntosh invited me to testify today regarding the privatization of Sallie Mae and Connie Lee. They have expressed a particular interest in my views on how privatization might affect stockholders of these organizations. I will confine my remarks to Sallie Mae since it is that company in which my clients and I have an investment.

I will begin by saying that the merits of privatizing Sallie Mae are best viewed within the context of the risk to shareholders of not doing so. On this issue the stock market has already rendered a harsh judgment. The threat to Sallie Mae's existence posed by the reduction and possible replacement of the market which the company was created

to serve has caused shareholders to vote with their feet. From its peak price several years ago, Sallie Mae's stock closed 1994 with a staggering loss of some $4 4 billion in market value. I want to underscore here that this enormous evaporation of the shareholders' money exceeds by nearly 50% all of the earnings that Sallie Mae has reported over the course of its 21 year existence. It also represents about twice the corporation's cumulative retained earnings which are a measure of stored value.

So, it can be summarized that Sallie Mae's shareholders have suffered an enormous, undeserved and unforeseen loss. Furthermore, if direct lending reaches the targets currently established and the 30 basis point offset fee remains in effect (even on securitized loans) I can foresee little chance that shareholders will recover their loss over a reasonable period of time.

Consequently I believe privatizing Sallie Mae so that it can utilize its considerable management, technical and financial resources to diversify its activities is the fair and intelligent solution to the company's problem. Although the likely effects of privatization are difficult to gauge at this moment, the consequences of leaving Sallie Mae straight jacketed in its GSE status strike me as both predictable and negative for shareholders. The losses already inflicted testify to the financial market's judgment about this company's prospects in the current operating environment. I wish to emphasize here that from our perspective the uncertainty of not knowing just how the company will be structured in a privatized mode is offset considerably by our complete confidence in CEO Larry Hough and his management team.

Let me conclude by registering a strong objection on behalf of all Sallie Mae shareholders to the imposition of an exit fee in return for privatized status. It is my understanding that proponents of this concept believe the Government should be paid for its role in creating Sallie Mae and the values which have been built up in the company over the last several decades. It is our view that these values have been substantially eroded by the Government's planned reduction in Sallie Mae's market along with the imposition of

the 30 basis point offset fee. We also reject the notion held in some quarters that Sallie Mae has been some sort of bonanza for shareholders and management. In that connection, let me point out that by our calculation, an investor who bought Sallie Mae stock at the close of 1983 in the aftermath of its initial public offering late that year earned a compound annual return of 11.75% over the ensuing 11 years ending December 31, 1994. By comparison, the overall stock market as measured by the S&P 500 Index returned 13.6% compounded.

So, in spite of the benefits conferred on Sallie Mae by its GSE status, the company's shareholders at this juncture find themselves worse off than if they had earned the average stock market return since Sallie Mae went public. The concept of an exit fee in this context surely must be rejected.

Thank you very much for the opportunity to appear before your committee. I will be happy to respond to any questions.

Chairman MCINTOSH. Thank you also for coming today and appearing before us. In the Government Reform and Oversight Committee, it's become our policy to have the citizen witnesses come first and then the government witnesses. We reversed that today, in part, because we are a joint hearing, but also, in part, I wanted to allow you to hear the testimony of the government officials and the regulators, and seek your comments on that, particularly, whether that—some of the concerns they raised could possibly lead to a situation where the privatization would be unacceptable to the shareholders.

You talked about the exit fee or the severance fee. Mr. Khedouri, do you have any comments on that? Then, I'd like to go through the offset fee and the ongoing obligation.

Mr. KHEDOURI. Well, certainly I can't speak with the degree of authority that Mr. Torray can, as a representative of a very large block of shareholders, but I do think in listening to the comments earlier that I personally have a certain amount of trouble understanding the concept that underlies this. The fact is that the shareholders of Sallie Mae, if one looks at the reality of a GSE, it is the debt holders who are the most insulated from risk by reason of the GSE status. They rest assured in the knowledge that there will be a draw on the Treasury if there were operational difficulties and shortfall that would make it impossible to service their debt. As a consequence, they accept extremely low yields.

The equity holders are not in that situation. I think the last two years have demonstrated that their values are not preserved by the GSE status necessarily. They've taken large reductions in market capitalization, and so you have to ask yourself, they made their capital available, it funded the investments of Sallie Mae in its facilities and in its operations, and they took out from that a relatively nominal return. They were, if you will, providing a service to the government through this period, and unless one can look back and say they had some extraordinary level of return, I think it would be hard to construct, in my mind at least, any good justification for saying there is something there that should be taken from them.

As a practical matter, anything that would be done, as the point has been made many times, you know, you would call into the question the value of the plan going forward for the company, you would make it more difficult to sever the GSE connection by reason of that, you would also potentially impair their future viability. And, even though, as I said earlier, there is no doubt that there would be a secondary market in student loans, Sallie Mae itself is the best position still, of course, to create and sustain that market. And so, you want them to be there in the future in that market, and I think you don't want to impair their viability as you sever the connection.

Chairman MCINTOSH. Any comments on the ongoing obligations of the contractual versus the legal matter, or whether that makes them viable in the marketplace with those type of requirements for either the debt or the equity holders?

Mr. TORRAY. Well, I've been surprised at the reaction or the notion that this company may desert the market. I think this is just a matter of economics, and if the economics of student lending

which have been historically, I think, pretty attractive, and are at the present time at least acceptable, remain that way, I would see no chance whatsoever that the company would abandon this market.

And, I also have a high degree of confidence in the integrity of the management, which I have come to know quite well in the last several years, and as a shareholder representing lots of other people, and knowing some other large shareholders, I believe that none of us would be interested in having this company desert the function for which it was created, which I think it has performed admirably.

Mr. KHEDOURI. I'd just say a word on that, one from my current vantage point, and one from my previous vantage point as a government official. Saying that you need to have a very rigorous, either legislative or contractual, set of obligations upon Sallie Mae is, to me, somewhat like saying that if you have someone who has spent their entire career and was trained to be an auto mechanic, that you have to make this person sign a piece of paper saying that when he does the work tomorrow he's not going to be an auto mechanic. That's what their expertise is, in student loans, their infrastructure is designed around student loans, they may wish to create other sources of revenue outside that, but it seems to, either from pressure from the shareholders who would certainly question management if they abandoned their core business, that you have a constraint in place already.

Second, as I said, from being a former official, it just strikes me that in a rapidly moving market, where Congress itself is a major player, because of the potential changes in the Guaranteed Student Loan Program, and whether it's—how much is direct and how much is not, that it's much more practical to have a contractual arrangement that can be modified without having to go through the lengthy process associated with legislation or even a rulemaking.

Chairman MCINTOSH. Thank you, thank you both.

Before we turn to my colleagues for questioning, let me just mention something that I communicated to Mr. Kanjorski in person. I apologized to him for not recognizing him yesterday for questions. That was an unintended mistake on my part, and I certainly would want to welcome everybody's opportunity to ask questions of the witnesses.

Mr. Williams, do you have any questions?

Mr. WILLIAMS. Thank you.

First, Mr. Chairman, let me ask you now for consent to place both my opening statement, as well as the opening statement of Mr. Chet Edwards, in the record at the beginning of the hearing.

Chairman MCINTOSH. Seeing no objection, that will be granted.

Mr. WILLIAMS. Gentlemen, we are faced these days in Congress with two alternative views that create a tension. One is privatization. The other is the demand of taxpayers that we be prudent, conservatively prudent with their money.

Let me use an example, the savings and loan. In the early 1980s, some of us believed that because of deregulation a fast and loose savings and loan industry, and little regulation on the top of it, we ventured forth with the taxpayers' money in an imprudent manner. It's going to be another couple of decades before the taxpayers get

over that one, and they are looking at this one with jaundiced eyes, in my opinion.

Mr. Torray has said, if I copied your words down right, if the attractiveness of student loans stay that way, then you expect that there wouldn't be a desertion. The hard fact is, the tensions before us, in my opinion, means that the attractiveness of student loans won't stay that way. As we try to reduce the Federal budget deficit, I think it is very clear from the new majority that we are going to go after student loans. We are going to go after tax exemptions. We are going to go after the subsidies.

Now, the question for the taxpayers is, if we privatize Sallie Mae, and their other businesses are not as lucrative as we hope, who is going to handle those loans? Is that going to be another bail out by the taxpayer if Sallie Mae is unable to do so?

I would like you both to respond to that, but I want to make one other point, and that is that huge, well-capitalized companies in this country have gone belly up. We saw it in the 1980s and we're seeing it in the 1990s. Restructuring of companies we never anticipated would have to be restructured. To paraphrase the words of Robert Burns, the best laid plans of mice, men and Wall Street brokers gang aft agly. If that happens here, the taxpayers may say, gee, Congress, congratulations, you weren't as prudent with our money as we demanded, even in the face of the savings and loan disaster.

Now, would you both play the other side of that tune for me?

Mr. TORRAY. Fred, do you want to play first?

Mr. KHEDOURI. Okay. Mr. Williams, I think there's a couple things to bear in mind. One is, we don't have here the insurance fund that was, of course, the reason we got into the savings and loan bail out. We had deposit insurance. We had regulation that did not cause the management of those savings and loans to protect their capital and absorb losses, and when they went under, their obligation to their depositors had to be met by the Federal Government.

Here, if you were to go forward and sever the GSE connection of Sallie Mae, on the basis that's been widely discussed, the GSE debt, which would be left outstanding, the bonds that have already been issued and are out in the marketplace today, would, essentially, be matched and balanced by the Guaranteed Student Loan assets that Sallie Mae has, and their businesses would be insulated from one another, and it would be possible to envision a situation in which the management had made misjudgments in their new businesses, and, you know, their stock price would tumble, and potentially the debt they issued after that time would be put at risk.

If that happened, a lot of people would lose a lot of money. Many of those people would be taxpayers. They would have lost their money in their capacity as investors, not as taxpayers. The Federal Government would have no exposure by definition. I think there would be no credible basis for an intervention in that market, because you'd have to say, well, your liability as the government is really on the loans themselves, right at the level of the guarantee, that's out there, that's for the benefit of the borrowers, what happens to the loans after that? You know, your issue would only be if Sallie Mae collapsed after it was made fully private, would there

be any secondary market student loans, and I think the answer to that question is yes. I think Sallie Mae is going to have tough competition, actually, as a fully private company, in its core business. There are a lot of people out there who can securitize student loans, and fund them, and make a secondary market.

So, the short answer is, no, it shouldn't be like the savings and loan situation anyway.

Mr. TORRAY. I think that's an excellent answer, and up to this point student lending has been such an economically attractive business, and I think some people have concluded that it's too attractive, and that's what has caused the margin within this company to some extent to narrow.

I think it's going to be a long time, Congressman, before the diversification of this company can take on the size and scope that would be anywhere near the size of the present student lending operation, and I sort of envision more of a service orientation as opposed to a financing orientation, but I really don't know what the future holds in that regard. And, in any event, other than the diversification issue, I think the company in its privatized status, the risk is about the same as it is in the GSE status.

Chairman MCINTOSH. Thank you, Mr. Torray.

Mr. Reed, do you have any questions?

Mr. REED. I believe it's Ms. Woolsey.

Chairman MCINTOSH. Is it, okay.

Ms. WOOLSEY. Thank you, Mr. Reed.

Chairman MCINTOSH. I was not here as people came in.

Ms. WOOLSEY. Thank you.

I just have a very short question for Mr. Khedouri. Is that the right way to say that, your last name?

Mr. KHEDOURI. That's good.

Ms. WOOLSEY. Does that work?

Mr. KHEDOURI. Yes, that's good.

Ms. WOOLSEY. All right, that wasn't my question, though. You were here earlier, and you heard the Department of Education, the Treasury Department panelists. In their testimonies, could you tell us where you would consider overregulation or contractual restrictions? I mean, were they talking about restrictions and overregulation that you would want us to be cautious of, and would you tell us what that would be?

Mr. KHEDOURI. Well, I didn't hear too much being said that was positive as far as the interests of the shareholders, you know, going forward, in terms of imposing a lot of restrictions. I think that the bargain is, if the GSE status is ended, then you get to operate like any other private company.

I did hear comments which, I guess from the gentleman from the Department of Education, which seemed to me to be overly pessimistic about the ability of the marketplace to provide liquidity for student loans. I think that may have been true a number of years ago.

I mean, you wouldn't believe the stuff we securitized. I mean, student loans is easy, because the credit is not really an issue. What's more of a problem is understanding when you get your payment, because of defaults and delinquencies, and assuring that the

payments flow through the system smoothly by how they are serviced.

And so, I think one shouldn't have a doubt about that. Yes, there is an issue with the tax-exempt entities that are in the secondary market, and whether they've run up against these caps on how much debt they can have outstanding. That is something, if it chose to, that Congress could address, but I also think that the taxable market absorbs volumes of other types of loans that far exceed the potential student loan volume, and it's not an issue. So, that's about it.

And, as I said, in my earlier comments, I heard a lot of discussion of exit fees and so forth. I, too, discerned a slight difference of opinion between the agencies, but it seemed to me that the Treasury Department's viewpoint, which is that, well, maybe it should be couched in terms of future creation of value through warrants or some other option, makes a lot more sense, you know, then saying we are somehow going to go back and rewrite the bargain that was made.

Ms. WOOLSEY. Thank you.

Chairman MCINTOSH. Thank you, Ms. Woolsey.

Mr. Reed, do you have any questions?

Mr. REED. Thank you, Mr. Chairman.

I want to pick up a theme that I concluded within my questions to the first panel, on which Mr. Williams elaborated in some detail. That is, I think if our assumptions are that the market is just going to be direct lending and the present Stafford loans, et cetera, that leads to one reality. But, I think given the proposal that we are hearing about eliminating the in-school subsidy for loans, and many other consequences of the budget reductions, I'm just wondering again, when you consider the future in your advice about Sallie Mae, whether you are fully, you know, looking ahead to that new reality. I was just wondering if you could comment upon that, either Mr. Torray or Mr. Khedouri. And, I guess I would say the comment is necessary, because I think Sallie Mae was created to ensure a comprehensive program across the United States, where every student, our constituents, could get access cheaply and efficiently to loans, and there's a danger that as these costs of education go up, cost of loans go up, that you are going to have private institutions getting out of the business, maybe not across the board but regionally, and we are not going to have a public entity that basically we can, you know, send in to regions of the country that are under-financed and say, you've got to do it.

And so, that's a concern I think we have to face as we consider this privatization. Any comments I'd appreciate.

Mr. TORRAY. Gee, I don't know what to say, Congressman Reed, in response to that. I just have such complete confidence in the integrity of this company, and its management, and in the performance, its past performance of the mission, and that confidence extends to my view of the future.

And, again, I believe that if the economics of student lending are attractive, there is always going to be, there will always be money available to that market. And, I do not have any fear that students in this country are going to be unable to finance their higher education. Now, I may be wrong in that.

Mr. KHEDOURI. I'd have to say this, you have to really—it's very important to divide the questions. If the terms of the student loan programs themselves are such that you create a piece of paper that has a value that is worth R at least, then this is not, and should not, be an issue. There will be funding available to those who wish to do that kind of lending.

If you were to make alterations, and it has nothing to do with privatizing Sallie Mae, if you were to try to force lending to take place on terms that were fundamentally unattractive to the marketplace, so that in my terms that you write a loan, and the day you wrote it it would be worth $95, no one would do that, and you can control that independent of this. You will control that by the terms that you impose on the Guaranteed Student Loan.

Another example would be if you were to impose—say you changed the basic term of the guarantee, so that the guarantee only covered 80 percent of the face amount of the loan, clearly, you will change—and then you limited the rate, if you do that people are not going to make Guaranteed Student Loans. Whether they can sell them into the secondary market or not, the secondary market can't deal with the underlying value of the loan. It can only efficiently capture that value once it has been created.

Mr. REED. It's an interesting topic, and I appreciate your interest, and I think it's something that we do have to get into in detail as we consider all of these issues.

But, one other topic I'd like to raise briefly, and that's the issue of the exit fees. I think, for my mind, there's two different perspectives. One is the technical requirements under our budget rules to make up the offset fee, and if Sallie Mae does not pay it going forward, then someone else has to pay it, so the issue is, is it fair that someone pays it, et cetera?

The other part of it, I think, is the notion that I think Mr. Torray alluded to, where is this concept of since the government sponsored, helped organize and provided support for Sallie Mae, isn't it appropriate going forward that we return some benefit to the taxpayers, which I think the Treasury is talking about in terms of warrants and provisions like that.

Separating those two issues out, it seems to me that we have an obvious immediate problem of pay go, and then we have a sort of fairness argument in the context of the warrants. Mr. Torray, you were quite eloquent and specific about your position, but I don't know if you'd like a second bite at the apple on this, or Mr. Khedouri, about this whole issue of exit fees.

Mr. TORRAY. Yes. Well, I mean, I think I said it all, that really, in retrospect, and it's much easier with hindsight, but had an investor in 1983 known where he would stand today if he had invested in Sallie Mae, and also known the nature of the rest of the financial markets, there wouldn't have been one person that would have invested. And, I believe that that fairly much offsets the notion that the government in this case has done us a big favor.

I mean, I'm not complaining. I have a very positive view about the future of the company, and I don't know anybody that's crying about what's happened in the past. But, I think to a certain extent, the imposition of an exit fee at this point is adding insult to injury.

The major losses that have occurred in this company, and I actually invested after they occurred, so I'm not one that gets hurt in this, but the $4.4 billion that was extinguished from the peak price to the low is gone, and I think a large number of the shareholders who held the shares at a higher price have since sold, and actually realized a loss, there will be no come back for them.

And, I believe in that context that it just—it seems very unfair to me that the company should have to pay some further funds to the Federal Government to extract itself from the situation.

Mr. KHEDOURI. I'd just reiterate a point I made earlier, which is the—I have not anywhere heard a logic enunciated that to me provides us a sound basis for an exit fee, or the nature of the exit fee, how you would go back and determine what was appropriate.

During its prior operations, Sallie Mae, you know, obviously paid taxes when it earned—paid Federal taxes, since this is the Federal Government, was paying taxes to the Federal Government as it had earnings, and it wasn't using the Federal Government's capital in any way directly. It, basically, its debt operations were facilitated by the agency status, and that benefit, I would argue, in large measure, I'm not an economist but I've been exposed to a lot of them, one could say that that benefit was captured, not by Sallie Mae and its equity holders, necessarily, it was captured by the lenders. It was captured in the form of increased value of the student loans that they sold.

And, in effect, their cost of raising—of selling debt was backed through the system in their ability to purchase student loans. And so, that's where the benefits lie. I don't think anybody, there's any way even to go back and capture that.

So, if you say, is there something that they've got today that you are supposed to take away from them that they got by reason of their GSE status, I don't think so. I think that what they have today represents the equity investments of the shareholders, and that's there money. It was never Federal money, and so, why would you make it Federal money by trying to take some of it away from them now.

Mr. TORRAY. May I add one thing to that, if I could just briefly. I think that if the exit fee concept had been developed when this company was at sort of the peak of its profitability, and the shareholders at that point had realized a well-above-average return, I think there would be something to the fact that the government had contributed to that return.

But now, in effect, the government, through its own activities, has canceled out all of that premium, and now the shares are at a level where they are just average.

Mr. REED. If the Chairman would indulge me for a moment, just a rejoinder. The concept of a warrant, though, in which there would only be a cashing in by the Federal Government if the company took off, did very, very well, and stock values rebounded, seems to me to be something more palatable than, oh, you have to pay us $5 billion to leave the system now or you can't get out.

Mr. TORRAY. Oh, sure. No, I think a warrant, if it's in the proper proportion, would probably—would not be objectionable to me.

Mr. REED. Thank you very much.

Thank you, Mr. Chairman.

Chairman MCINTOSH. Thank you.

Does any other Member of either committee have questions for the panel?

Let me just close in saying that I'm a little puzzled by some of the claims that Sallie Mae doesn't have—there isn't competition out there, just because USA group is located in Indianapolis, near my district, and I know they would be very happy to accept some of the loans, so I think there will be plenty of opportunities in the marketplace to make sure that these services are provided for us there.

I want to again thank Mr. McKeon and his subcommittee, and particularly, the staff of his subcommittee for all of the hard work they've done, and to thank the staff of my subcommittee on this issue. I think it has a potential for being a tremendous precedent for moving forward in this area, both on the level that Speaker Gingrich talks about, of taking into account third wave technologies, where computerization now allows us to use securitization of finances, and also demonstrating that it is possible to see an end to a government program and still have the public well served.

So, I appreciate all of those who participated in this, and this committee, joint committee hearing is now in adjournment.

[Whereupon, at 11:49 a.m., the joint subcommittee was adjourned.]

[Additional copy submitted for the record follows.]

STATEMENT OF HON. PAUL E. KANJORSKI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

It is extremely gratifying to attend today's hearing on the privatization of Sallie Mae and Connie Lee.

We are about to embark on a historic first for the Federal Government. We are poised to take a government-sponsored enterprise which has served its purpose and spin it off to compete in the private sector. Without the binding force of a restrictive charter written into law, Sallie Mae will be able to use its personnel and technical expertise to become an innovative and dynamic force creating growth in our economy.

This type of innovation is at the core of the reinventing government initiative begun by Vice President Gore over two years ago. The favorable testimony we will hear today is a result of that effort challenging conventional assumptions, encouraging original thought, and breaking new ground. It is particularly encouraging to see that this privatization effort is bipartisan.

Certainly there are some issues which remain unsettled, but I am confident that with the cooperation of the Members of this panel, our counterparts in the Senate, the administration, Sallie Mae, and other concerned interests, we will be able to amicably resolve any remaining unanswered questions and points of difference.

I look forward to hearing the testimony of our witnesses today.

STATEMENT OF HON. JAN MEYERS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

I want to thank the Joint Committee for including my comments in support of privatizing the Student Loan Marketing Association, also known as Sallie Mae. While the topic of this hearing is the privatizing of all Government Sponsored Entities [GSEs], Sallie Mae has expressed a particular desire to privatize.

Sallie Mae was created in 1972 to provide fiscal liquidity to the private market for federally-insured student loans. Since then the secondary market has flourished and Sallie Mae now has significant competition in their only allowable market. At the same time, implementation of direct lending which began last Congress further shrinks Sallie Mae's available pool of clients.

Privatization would allow Sallie Mae to operate in any number of financial markets and thereby increase the value of their stock for their shareholders. As I understand current proposals to privatize Sallie Mae, their existing portfolio would be placed in a liquidating GSE, this entity would continue to pay the offset fee which Sallie Mae currently makes to the Treasury. A holding company would be created to provide for Sallie Mae's private activities after January 1, 1997.

I support proposals to privatize which would allow Sallie Mae greater autonomy in the future and provide a reasonable return on investment to both the shareholders and taxpayers.

STATEMENT OF HON. CHET EDWARDS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Chairman McKeon and Chairman McIntosh, thank you for allowing me to join you today to make the following comments.

One of the recognized messages from the last election is that American citizens want less government. That is a sound concept. And in agreeing with them, many of my colleagues, along with Secretary of Education Riley and former Secretary of Treasury Bentsen, believe that allowing Sallie Mae to become a private company with no government ties makes a great deal of economic and public policy sense.

From the government's perspective, privatizing Sallie Mae makes enormous sense. It will firmly establish that the Federal Government can reinvent itself when the time comes to do so. Sallie Mae would then be subject to State and local taxes for the first time, providing those governments with new sources of revenue.

I come to this issue from the perspective of a Member who has seen what Sallie Mae can do in a community when it invests, when it hires people, trains them and becomes an active member of our communities. In my district, Sallie Mae operates the Killeen Service Center, which employs over 700 people and which has been a great engine of growth in Central Texas.

Privatization makes good sense from Sallie Mae's perspective also. As it graduates from its government role, Sallie Mae will be subject to the challenges of the market instead of the politics of Washington. As direct lending is implemented over the next few years, the purchase of student loans, Sallie Mae's core business, will decline.

Privatization would allow Sallie Mae to utilize the skills of its employees and the tools it has developed to go beyond the servicing of student loans. Not that it would stop doing what it probably does better than any other entity in the country, but it would not be confined to that small niche.

Finally Mr. Chairman, Sallie Mae's privatization should go forward because of the precedent it will set in today's environment. Successful Federal-related entities that have fulfilled their public missions should be encouraged to transform themselves into private business. This is one important way to make our government leaner and more effective.

Thank you for giving this important issue proper consideration.

STATEMENT OF HON. DOUGLAS [PETE] PETERSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Thank you for the opportunity of providing my viewpoint on this important issue. Although the joint committee will hear testimony on the privatization of other government-sponsored entities, I would like to focus my remarks solely on the Student Loan Marketing Association [Sallie Mae].

Mr. Chairman, I view the restructuring of Sallie Mae into a completely private sector enterprise as a proposition without a downside. This is clearly as win-win situation. Given the changes that have taken place in the student loan industry, I believe we must pass timely legislation giving Sallie Mae the flexibility to reposition the corporation and redeploy its private equity capital [both individual and institutional savings] productively.

Equally important, the unprecedented privatization of a GSE would send a strong signal to the American people that this Congress is serious about fundamentally restructuring the way the government operates. With the public call for less government, this represents an excellent opportunity for us to seize this issue as proof of our commitment to downsizing the Federal Government.

Sallie Mae's Federal charter was established in 1972 to help ensure adequate private sector funding for federally guaranteed education loans. Sallie Mae has fulfilled this charter to a much greater extent than anyone thought possible. Now, because the need for a government-sponsored secondary market for guaranteed student loans has greatly diminished, the time has come to allow Sallie Mae to use its considerable resources to enter into other projects. Having seen the organization at work firsthand, I have full confidence in the ability of Sallie Mae to handle any project it undertakes. The potential upside for privatization of Sallie Mae is limitless.

Both committees are to be commended for adding this issue to their busy agendas. Again, I appreciate the opportunity to add my insight, and fully support privatization of the Student Loan Marketing Association.

STATEMENT OF HON. THOMAS M. DAVIS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

I am very pleased to have the opportunity to be a part of this joint hearing to consider the privatization of Sallie Mae [the Student Loan Marketing Association]. While many Members have been discussing the concept of privatization in abstract, this hearing provides an historic opportunity to turn those discussions into reality. Unlike many of the privatization targets that have been named by the administration, by leaders like Chairman McIntosh and Representative Klug, and by numerous Washington think tanks, Sallie Mae is a willing partner for privatization. It is ready, willing, and able to shed its government ties and face the challenges of operating as a fully private company.

Many of you may be unfamiliar with Sallie Mae, which was established in 1972 to provide financial liquidity for banks and others making student loans under a government guaranteed program. Sallie Mae and the student loan marketplace have grown in extraordinary fashion since that time. Today, more than $25 billion in loan funds are provided to students and parents across this Nation. In 1993, the Clinton Administration led an initiative to replace the guaranteed loan system with a program of direct Federal lending. This development has had a major impact on Sallie Mae, which is restricted by its Federal charter from branching out beyond the student loan business. This means that it is unable to replace the share of the student loan marketplace—which could reach up to 60 percent of that market—that is being subsumed by the Federal Government. In my district in Northern Virginia, that limited business horizon has already resulted in the loss of 300 jobs.

Congress should not miss this historic opportunity to recharter a Government Sponsored Enterprise as a fully private company. But, it must act while the company is still healthy and before it encounters further economic uncertainties. Sallie Mae is a company on the cutting edge of technology and with a rare knowledge of the higher education community. I am confident that by allowing the company to build upon its student loan business it will serve a number of public needs that could not be anticipated by the Congress. We should not pass up the chance to relieve the American taxpayer of $50 billion or more in implicit liability for Sallie Mae's obligations.

It is important to urge caution against the temptation to make the company "pay" for the privilege of being rechartered. Sallie Mae's support of the students and parents of this Nation more than outweighs any perceived or actual benefits it has received from its government connection. To exact an "exit fee" or similar price from the company could limit the company's opportunities to be successful after rechartering. Sallie Mae is already challenged to ensure that its privatization plan replaces Federal revenues that are expected to be collected from the "offset fee" imposed on the company in 1993. A privatization package that handicaps Sallie Mae financially and limits its ability to thrive as a fully private company could cast a shadow over other efforts to privatize government functions—a number of which, I hope, will be considered by this Congress and this committee in the coming months.

STATEMENT OF HON. CARDISS COLLINS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Thank you Mr. Chairman for holding this hearing. When Sallie Mae was created in 1972 there were no companies buying student loans from banks and savings institutions. Those institutions had strict limits on how much capital they could devote to these loans. The creation of Sallie Mae, to buy and manage these loans, freed up millions of dollars for new student loans.

Similarly, when Connie Lee was created, it needed the full faith and credit of the Federal Government to decrease the interest rates charged to these colleges and universities.

Now Sallie Mae has 42 competitors and its stock is traded on the New York Stock Exchange. Connie Lee is a thriving corporation whose own assets are sufficient to bolster the credit rating for these colleges and universities. It is no longer clear that there is a public policy to be served by the government assuming this risk. It is appropriate then to ask if now is the time to privatize these establishments and free the public of that risk.

There is little agreement among those who compete with Sallie Mae, or among those who would be competitors if Sallie Mae is privatized. Some of Sallie Mae's competitors fear that privatization will make it more difficult for them to compete with Sallie Mae. Companies in other markets, like Fannie Mae, oppose privatization of Sallie Mae, because it would allow the company to enter other markets, and thus become a competitor to companies like Fannie Mae. On the other hand, some of Sallie Mae's competitors support privatization because they believe that the existing government backing gives Sallie Mae an unfair competitive edge.

I think there is one overriding question that needs to be answered at this hearing. Will the privatization of Sallie Mae and Connie Lee hurt or help the availability of loans for students or construction funds for colleges? If not, then privatization is a good idea. If privatization decreases the funds available for loans to students then Sallie Mae should remain a Government Sponsored Enterprise. Similarly, if this action reduces the ability of colleges and universities to get construction loans, then Connie Lee should remain a GSE.

Another concern is that Connie Lee may not have fulfilled its public policy mission. When Connie Lee was created part of its mission was to help historically Black colleges and universities to get construction loans. That hasn't happened. Ten years later there are few if any construction loans to Black colleges in Connie Lee's portfolio. I doubt privatization will change that.

There has been talk about requiring Connie Lee to repay the start up money initially advanced to it by the Federal Government. One possibility would be to use that money for the original policy mission that remains unfulfilled—to back construction loans for the historically Black colleges and universities that have been left out of Connie Lee's portfolio.

Again, thank you Mr. Chairman for holding this hearing. The relationship of Government Sponsored Enterprises to the Federal Government is a complicated one. It is also one which changes across time, and so revisiting this issue periodically is useful.

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